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UNITED KINGDOM

Medium term economic trends and problems

D. Adams S. Gillespie M. Green H. Wortmann

Internal paper

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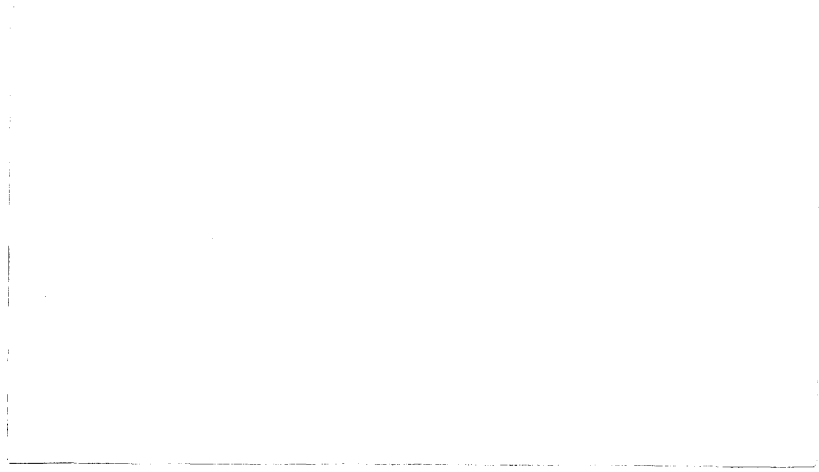

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U N I T E D K I N G D O M

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ABSTRACT

This paper is an analysis of the main medium-term economic trends and issues in the United Kingdom and forms the first part of an exercise being undertaken by the Commission staff to review medium-term developments in each of the Community countries. The paper describes the economic trends in the United Kingdom over a period of years, considers the medium-term outlook as foreseen by a number of independent forecasters and examines in particular the following issues : investment and productivity, the labour market, competitiveness and import penetration, structural trends, and the impact of North Sea oil.

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CONTENTS

LIST OF TABLES

LIST OF GRAPHS

AVREVIATIONS AND SYMBOLS USED

B	Belgium
DK	Denmark
D	Federal Republic of Germany
GR	Greece
F	France
IRL	Ireland
I	Italy
L	Luxembourg
NL	Netherlands
UK	United Kingdom
EC 10	Total of the member countries of the European Community
EC 9	Community without Greece
BLEU	Belgo-Luxembourg Economic Union
UKL	Pound Sterling
cif	Carriage, insurance and freight
Eurostat	Publication of Statistical Office of the European Communities
fob	Free on board (valuation basis for exports or imports of goods)
GDP(GNP)	Gross domestic (national) product
GFCF	Gross fixed capital formation
OECD	Organisation for Economic Cooperation and Development
OPEC	Organisation of Petroleum Exporting Countries
SOEC	Statistical Office of the European Communities
:	Data not available
,	Decimal point
-	Not applicable

I. FOREWORD

The Directorate General for Economic and Financial Affairs (Directorate A) is presently undertaking an examination of the medium-term economic trends and problems, as well as related policy issues, for the individual member countries of the Community. These studies may be considered extensions of the analytical reports which the Commission services prepared as supporting material for the Fifth medium-term economic policy programme. They remain the sole responsibility of the Commission's services and are not intended to have a normative character.

In many respects the economic outlook for the European Community is none too bright. Common worrying features for most countries are : low growth, high unemployment, inflationary pressures, lack of balance in the external accounts, high government deficit, decline in productivity growth, loss of competitiveness, high wage costs and pressure on company profits, low investment and slow adaptation of the structure of economic activity to a rapidly changing environment.

Policy makers in the United Kingdom face most if not all of these difficulties. The present report is written with a view to identify the specific British problems and to illustrate these by appropriate references to the situation in other Member States of the Community.

The report has been written for a general public, and in particular for non-British readers, who may require comparative information on the longer-term economic trends and problems in the United Kingdom. In order to keep the size of the paper manageable it has been necessary to be selective, concentrating the main emphasis on the real side of the economy. This is not

to say that the financial side of the economy is unimportant and it must be borne in mind that the present Government has stated that without a reduction in inflation and more stable financial conditions there will be no lasting improvement in the underlying economic performance of the United Kingdom.

II. THE MEDIUM-TERM EVOLUTION OF THE UK ECONOMY

Output and the use of resources

Over the last two decades the performance of the UK economy has been less satisfactory than that of other European countries; the UK has suffered from a slower rate of economic growth and a slower increase in living standards than elsewhere. Associated with and partly accounting for this poor growth performance has been a low rate of growth of fixed investment and an inadequate capital stock, which in turn is an important factor in explaining the low rate of growth of labour productivity. The latter, when combined with the UK's tendancy to above average wage inflation, has placed downward pressure upon investment profitability, so further reducing the incentive to invest.

As a result of these developments the UK economy has remained weak in the face of external competition, both in domestic and in third markets, and the external position has been vulnerable to even relatively modest rates of growth of output and demand.

The longer-term performance of the UK with regard to growth, employment and productivity is set down in Table II.1 where figures are also given for the Community as a whole (EC 10) and for the Federal Republic of Germany (a country with which the UK is compared in this document although it must be recognised that the economies are distinctly different in many respects).

It can be seen that with regard to both the overall growth of output and the growth of manufacturing production, the UK's performance was well below that of the FR of Germany and EC 10, in the period to 1973. At the same time the growth of output per head (total productivity) was much slower, but the rate of unemployment was close to that in the rest of the Community.

From 1974 onwards, as the Western economies adjusted to the first oil price shock, the UK continued to perform less satisfactorily than other countries. Indeed, the output of manufacturing industry actually fell at an average annual rate of almost 2 % in the six years to 1980, and the rate of decline foreseen for 1980 and 1981 taken together (almost 17 %), is significantly greater than that recorded between 1929 and 1931 at the time of the Great Depression (1). At the same time total employment declined, unemployment rose well above the Community average, and the growth of productivity continued to be far more sluggish than elsewhere. These developments occured as the UK was undergoing an important structural change, namely its emergence, by the end of the nineteen seventies, as a significant producer of crude oil. To show the importance of North Sea oil Table II.1 gives official estimates of GDP growth that exclude crude oil output. As Graph II.1 shows on this basis the level of GDP, at mid-1981, was no greater than in 1975.

However, in contrast to the movements in output, real national disposable income (2) and in particular real personal disposable income (RPDI), advanced significantly faster than GDP from 1974 onwards (see Table II.2). At the same time GDP per head in the UK, measured in European Currency Units (Ecu), has once again approached the average for the Community as a result of favourable exchange rate movements. The growth of real incomes was particularly rapid in 1978 and 1979 while in 1980 RPDI rose by 2 % at a time when GDP fell by 3 %. These movements in

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(1) By 1931 manufacturing output had fallen to 11 % below the 1929 level. A very modest recovery was recorded in 1932 (Feinstein, 1972).

(2) Real national disposable income differs from GDP in that it takes account of net property income from abroad and net transfers abroad, together with changes in the terms of trade. An improvement in the terms of trade means that a given volume of domestic output can be exchanged for a larger volume of overseas output (imports).

real incomes were reflected in the behaviour of private consumption. Between 1979 and 1981 private consumption is forecast to rise by 3 1/2 % and GDP to fall by 3 1/4 % (see Table II.2). These developments may also be considered a reflection of the structural change caused by increased North Sea oil output which, it can be argued, partly accounted for the marked appreciation of the sterling exchange rate. This benefited real incomes significantly so helping to strengthen consumer spending. Whilst consumption advanced, fixed investment in the UK declined somewhat between 1974 and 1980, compared to a modest expansion elsewhere. Although this was partly due to the marked fall in general government fixed investment, reduced by successive governments in their efforts to bring public expenditure under control, the performance of manufacturing investment was also relatively disappointing. The contrasting movements of output, private consumption and investment are set down in Graph II.1 and in Table II.3.

Besides having a significant impact on the structure of production, North Sea oil output has also affected the external position and Government revenues. By the middle of 1980 the UK's balance of trade in crude oil had moved into marked surplus although the more detailed analysis further below suggests that, for 1980 as a whole, the balance of payments for all North Sea operations is likely to have remained modestly in deficit (3). The contribution of North Sea production to government revenues has also become significant with oil production related forms of taxation reaching some 6 % of total government revenues in 1980.

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(3) The balance of payments for all North Sea operations covers trade in crude oil plus capital and service items related to North Sea production and exploration (European Economy No. 8, March 1980, pp. 88-90).

Incomes and prices

For over a decade there has been a tendency for the UK to suffer higher rates of inflation than its European trading partners. The divergence became particularly marked in the six years to 1980 (4) (see Table II.4). However, the data points to a substantial easing of inflationary pressure from mid-1980 onwards and in 1981 the UK rate of consumer price inflation moved toward the average for the Community.

An analysis of average annual rates of consumer price inflation tends to obscure one feature of the UK's recent inflationary experience, namely the extent to which changes in consumer prices have moved sharply, year by year, around the annual average. These deviations from the trend value are significantly greater than those recorded in the F.R. of Germany and for the Community as a whole (see Table II.5 and Graph II.3).

Table II.6 sets out the contribution of the main inputs to the rise in the price deflator of total final expenditure (consumption plus investment plus exports). The table clearly shows that labour costs grew significantly faster than prices from 1978 onwards, with the consequent growth of real earnings well in excess of the growth of labour productivity (see Table II.1). On the other hand the strength of sterling had a moderating effect on inflation in both 1978 and 1980. The marked increase in import prices in 1979 reflects the second oil price crisis. The table also shows that in the period covered, net taxes on expenditure have increased at a faster pace than the rate on inflation itself. Indeed increases in indirect taxation have been so marked in recent years, that the proportion of indirect tax revenues in

(4) From an analysis of the historical data it can be argued that, over the much longer term, the UK has experienced lower rates of inflation than most other industrialised countries (Smith, 1981).

GDP, at 17,5 % in 1980, is higher than in other Community countries (with the exception of Denmark and Ireland) and significantly higher than the 13,8 % average for the Community as a whole in 1980 (European Economy No. 9, July 1981, Ch 9). In 1979-1980 the small contribution of gross trading profits limited the increase in prices (see Table II.6). Thus the strength of sterling, which sharpened competition in both internal and external markets, and relatively rapid wage inflation, led to a substantial reduction in profit margins so exerting considerable downward pressure on the profitability of investment. As a consequence, by early 1981 the real rate of return on the capital of (non North Sea) industrial and commercial companies had fallen to 2 %, the lowest level recorded over the past two decades (Bank of England Quarterly Bulletin, September 1981, p. 318).

Public sector price increases have been far greater than those in the private sector. This has arisen partly because of the monopoly position of nationalised industries, and partly because of the financial constraints imposed upon them by the authorities as a general element of their firm monetary and fiscal policies. As a consequence some have been led to argue that it is the unsatisfactory behaviour of nationalised industries that has helped to fuel inflation (Johnson, 1981).

Such analyses help to illustrate aspects of the inflationary process but do not reveal much about the fundamental causes of inflation itself. Indeed the underlying causes of inflation are still much disputed. One major school of thought is that inflation is the result of excessive monetary expansion, resulting from or assisted by, excessive levels of public sector expenditure or borrowing (Smith, 1981; Beenstock, 1980). These views have formed the basis of the anti-inflationary policies of UK Governments since 1976. In particular official target ranges for the growth of the monetary aggregates have been announced since mid-1976 with a view to influencing inflationary expectations.

(3)

Nevertheless, there is no general agreement amongst economists, as to the mechanisms by which monetary and fiscal control reduces the rate of inflation, particularly in the UK case, where it has been argued that the institutional structure of the financial markets is not ideal for the implementation of monetary policies. Indeed, shifts of sentiment in financial markets have on occasion led to difficulties in implementing monetary policy. However, it is now widely accepted that a firm monetary and fiscal policy provides a necessary though not a sufficient basis for reducing the rate of inflation.

Most explanations of inflation that do not depend upon monetary phenomena may be termed institutional. Thus it can be argued that it is the existence of large institutions in the UK (nationalised industries and trade unions) which exert monopoly power in the labour and product markets capable of overcoming monetary and fiscal restraint, which has led to build up of inflationary pressures (5). Those who subscribe to this view of inflation usually propose that inflationary pressures should be overcome by prices and incomes policies. Indeed between 1976 and 1979 the authorities obtained the agreement of the Trade Union movement to a voluntary incomes policy ('Social Contract') with a view to limiting wage inflation. Some have argued, however, that such arrangements aggravate the situtation, since wages policies are normally expressed in the form of an agreed average annual increase in earnings, and in the bargaining process this rapidly became a minimum increase. Price policies can also be criticised on the grounds that they lead to market distortions and to the misallocation of resources, thereby adding to inflation in the longer term. Related to the institutional point of view are those

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(5) A particularly strident statement of this position is contained in "International Currency Review, 1981, pp. 78-84".

who argue that money wage inflation adjust downwards with great difficulty and that inflation can only be reduced by lowering unit labour costs, and to do this output must be increased (Cambridge Economic Policy Review, April 1981).

From an analysis of the movements in the rate of inflation since 1976 when the authorities began to base their anti-inflation strategy on firm monetary and fiscal policies, it is not possible to point to one or other explanation of inflation as being the correct one. Some would argue that the fall in the rate of inflation between 1980 and 1981 is the result of monetary policy and in particular of the slow growth of the money supply as narrowly defined (Metzler 1981). Others would argue that the strength of sterling was the major factor in reducing inflation (to which Table II.6 gives some support) and is in turn partly the result of an important structural change, namely the emergence of the UK as an oil producer. Yet again the sharp fall in output and employment in the UK in 1980 and 1981 is likely to have limited the monopoly power of certain institutions, so moderating inflationary pressures.

It is perhaps most reasonable to argue that inflationary pressures in the UK are generated both by monetary phenomena which affect the level of demand in the economy and by the influence of large institutions in wage and price setting markets. In this case the moderation in wage and price inflation from mid-1981 onwards (see Table II.1) will have been partly due to monetary and fiscal policy which has clearly been on the firm side, but perhaps not as tight as the authorities intended, and partly due to the moderation of monopoly power. Under this hypothesis it is not possible to argue conclusively that inflationary pressures will remain subdued once a recovery begins although tight monetary and fiscal policies should help to keep these forces under control.

Trends in the external accounts

It is often argued that one manifestation of the competitive weakness of the UK economy has been the tendency for the current account of the balance of payments to deteriorate as soon as the rate of growth gains momentum. This itself is often seen as being due to an unsatisfactory development of demand at times of rising activity, with the growth of private consumption the dominant expansionary force, leading to the diversion of exports to the home market, and to the excessive growth of imports.

An examination of the data however suggests that the UK's external weakness is more than just a cyclical problem, and that there has been a steady long term deterioration in the external position. Thus Tables II.7(i) and II.7(ii) show clearly that the performance of UK manufactured exports, up to the mid-nineteen seventies, was unsatisfactory with the UK's share of world manufactured exports falling by almost 50 % between 1960 and 1977. Over the same period the annual average volume growth of the UK's manufactured exports, at 4,9 %, although somewhat greater than that of GDP, was significantly below the figures for the F.R. of Germany (8,3 %) or the EC as a whole (8,1 %), where exports have been rising in line with the growth of world trade in manufactures.

On the import side Table II.8(i) shows the extent to which import penetration in the UK market for manufactured goods has increased in the period since 1970, particularly in engineering goods, vehicles, and clothing and footwear. Although greater import penetration can be a reflection of vigorous world trade growth and greater trade specialisation (something which most Governments in the Western world have been eager to promote in the post-war period), it is helpful for such penetration to be accompanied by an adequate rate of export volume growth, to avoid generating external pressures. Table II.8(ii) shows however, that as far

as manufactured goods are concerned, the volume of UK imports have grown much faster than exports whereas in the F.R. of Germany the growth rates were much closer (6). This inadequate performance in manufactures clearly contributed to the marked deficits on visible trade recorded by the UK to the mid-1970's which were, however, offset to a significant degree by surplusses on the invisibles side (see Table II.9), where the UK performance is impressive.

The performance of the UK economy on the external side has changed considerably from the mid-nineteen seventies onwards, largely due to the effects of the following three factors :

- the accesssion of the UK to the European Community at the beginning of 1973;
- the build-up of North Sea oil production and the emergence of the UK as a significant oil producer;
- a change in the approach to macro-economic management and in particular the firm monetary and fiscal policies pursued from mid-1976 onwards.

UK accession to the European Community, together with the increased production of crude oil, much of which is exported to other Community countries, has had a significant impact on the UK's pattern of external trade both for imports and exports. Table II.10 shows that, towards the latter part of the seventies, the proportion of UK exports to the Community, and imports from the Community, increased significantly as a proportion of total exports and imp orts. Indeed by 1980, trade developments with the Community had become so favourable as to yield a modest surplus on the balance of trade (on a fob/fob basis) following the substantial deficits since the nineteen sixties.

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(6) A recent detailed study of the behaviour of the volume of UK manufactured imports confirms the existence of a substantial trend rise which appears to be largely unaffected by cyclical changes in demand (Hibberd and Wren-Lewis, 1978).

Sterling strengthened significantly between end 1976 and early 1981, contributing to the very marked loss in export price competitiveness observed over the same period, but also to the sustained improvement in the UK's terms of trade (see Table II.11). This movement has been partly due to the emergence of the UK as an oil producer. In addition the shift of emphasis in macro-economic policy towards firm monetary and fiscal policies, with announced target ranges for the growth of the money supply as broadly defined, and limits to the Public Sector Borrowing Requirement, had a favourable effect on sentiment in financial markets, and will have added momentum to the strengthening of sterling. This marked sterling appreciation followed a five year period of sterling decline, lasting to mid-1976, which, given the time lags involved, benefited the volume growth of manufactured exports in later years. Consequently, towards the end of the 1970's the UK's increasing exports and falling imports of crude oil, together with the value of manufactured exports benefiting from earlier falls in sterling, amplified by improvements in the terms of trade, finally helped to move the balance of trade into surplus (7). In particular the UK was able to maintain its market share in manufactured exports from 1975 onwards (in value terms) and even to record marginal improvements. These trends in the UK's export market share to 1979 and 1980 are observable at both the aggregate and the detailed level, with the share of markets for particular manufactured goods advancing significantly (see Table II.12). However the accumulated loss of export price competitiveness is now

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(7) It should be stressed that the recent movements in import volumes have also been favourable to the balance of payments; in particular, in response to the move into recession in 1980, import volumes fell very sharply indeed (see Table II.9) and are foreseen to continue to do so in 1981.

being reflected in the movements of export volumes with a very sharp fall indeed occurring through 1980 (see Table II.7 (i) and (ii)) (8).

The contribution of North Sea oil to the balance of payments remains large : the UK's net balance of crude oil trade is expected to be in surplus in 1981 (see Table II.13). However, when account is taken of all balance of payments items related to crude oil production, on both current and capital accounts, a modest deficit remains, although there should be a move into surplus in the mid-nineteen eighties.

Table II.14 summarises developments in the UK's overall balance of payments position since 1970. The table shows in particular the substantial increase in private capital outflows towards the end of the period, which are a reflection of the gradual relaxation and then removal of exchange controls in 1979. At the same time, there has been a marked build-up of external liabilities in sterling, in particular of official sterling holdings.

The official reserves increased dramatically in 1977 (a period of strong sterling recovery resisted to some extent by the authorities), fell slightly in 1978, and showed more moderate changes thereafter. The level of gross reserves now stands at UKL 24 billion, about 12 % of GDP or 50 % of the annual imports bill.

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(8) The fragmentary information available for 1981, suggests that UK market shares have begun to fall once again.

Table II.1 : Indicators of output and employment, 1958-1982

	Annual average 1958-1967	Annual average 1968-73	Annual average 1974-80	1979	1980	Forecast 1981	Forecast 1982
Growth rates of GDP in volume terms (%)							
United Kingdom; including North Sea oil (a)	3,3	3,3	0,5	2,2	-3,0	-2,7	1,6
excluding North Sea oil (a)	-	-	0,1	1,3	-3,1	:	:
F.R. of Germany	4,8	5,3	2,3	4,4	1,9	-0,3	2,2
EC-10	4,6	5,0	2,2	3,4	1,1	-0,5	2,0
Growth rates of manufacturing production (%)							
United Kingdom (manufacturing industry)	3,5	3,9	+1,3	0,2	-9,4	-7,7	2,9
F.R. of Germany (industrial production excl.constr.)	5,1	6,9	1,4	5,5	-0,1	-0,5	2,5
EC-10(industrial production excl. construction)	4,8	5,8	1,5	4,8	-0,7	-2,8	2,9
Growth of GDP per person employed (%)							
United Kingdom	3,1	3,4	0,8	1,6	-0,8	0,9	2,7
F.R. of Germany	4,6	4,7	2,8	3,2	0,9	0,7	2,7
EC-10	4,5	4,6	2,1	2,6	0,9	0,8	2,1
Growth of total employment (%)							
United Kingdom	0,2	-0,1	-0,3	0,6	-2,2	-3,6	-1,1
F.R. of Germany	0,2	0,6	-0,5	1,2	1,0	-1,0	-0,5
EC-10	0,1	0,4	0,1	0,8	0,2	-1,3	-0,1
Numbers unemployed as a % of civil active population							
United Kingdom	1,8	2,7	5,0	5,3	6,9	10,2	11,3
F.R. of Germany	1,2	0,9	3,6	3,4	3,4	4,8	5,6
EC-9	2,3	2,3	4,9	5,5	6,1	7,8	8,5

(a) Output measure

Source : Eurostat and Commission staff.

(4)

Table II.2 : Indicators of output and demand, 1958-1982

	Annual average 1958-67	Annual average 1968-73	Annual average 1974-80	1979	1980	Forecast 1981	Forecast 1982
Level of GDP per capita in ECU (a) ('000s)							
United Kingdom	1,5	2,2	4,3	5,2	6,6	8,0	8,4
F.R. of Germany	1,5	3,2	7,3	9,1	9,6	9,9	10,9
EC-10	1,3	2,6	5,4	6,6	7,4	8,1	9,0
Growth rate of volume of private consumption (%)							
United Kingdom	2,8	3,5	1,1	3,5	0,7	-0,6	-0,3
F.R. of Germany	5,0	5,1	2,7	2,7	1,7	-1,3	1,0
EC-10	4,5	4,9	2,6	3,4	1,5	-0,3	1,1
Fixed investment							
- volume growth (%)							
United Kingdom	6,1	2,8	-0,7	-1,4	-2,0	-5,0	0,9
F.R. of Germany	5,0	5,9	1,9	8,5	3,7	-3,8	-2,1
EC-10	5,9	5,2	0,6	3,8	1,8	-3,7	-0,8
- as a % of GDP							
United Kingdom	17,3	18,8	18,7	17,8	17,5	16,9	16,8
F.R. of Germany	24,8	24,7	21,7	22,7	23,7	23,0	21,9
EC-10	21,5	22,5	21,2	21,0	21,3	20,8	20,1
Real national disposable income (% change)							
United Kingdom	3,4	3,5	0,7	2,8	-0,4	:	:
Real personal disposable income (% change)							
United Kingdom	3,8	4,4	1,8	6,3	1,9	-3,0	-0,9

(a) European Currency Units, (ECU), at current prices and exchange rates.
Source : Eurostat and Commission staff.

Table II.3 : Changes in components of demand and output, 1977-1980

	Average annual rates of change (%) 1977 - 1980
Change in income from employment at current prices	16,3
Change in consumer prices index (1975 = 100)	12,1
Volume changes	
Real personal disposable income	5,5
Private consumption	3,8
Fixed investment	0
Exports (goods & services)	1,5
Imports (goods & services)	3,7
Gross domestic product at market prices (1975 = 100)	1,1
Manufacturing production	-3,2

	Levels	
	1977	1980
Effective exchange rate (1975 = 100)	81,2	96,1
Oil output (million tonnes)	38,3	80,5
Employment in manufacturing industry(million)	7,3	6,8

Source : Economic Trends, HMSO

Table II.4 : Indicators of inflation, 1958-1982

	Annual average 1958-67	Annual average 1968-73	Annual average 1974-80	1979	1980	Forecast 1981	Forecast 1982
Changes in consumer prices (%)							
- United Kingdom	2,9	6,7	15,5	12,5	15,5	11,8	10,5
- F.R. of Germany	2,6	4,6	4,9	4,2	5,4	5,8	4,5
- EC-10	3,2	5,5	10,6	9,6	11,9	11,6	10,5
Changes in per capita compensation of employees (%)							
- United Kingdom	6,1(a)	10,9	18,0	16,3	20,9	12,1	8,9
- F.R. of Germany	7,7(a)	11,2	7,4	5,7	6,5	5,6	4,3
- EC-9	8,1(a)	11,4	12,9	10,7	13,8	11,5	10,8
Changes in nominal labour costs per unit of output %							
- United Kingdom	3,6(a)	7,3	16,6	15,5	21,9	10,2	6,2
- F.R. of Germany	3,5(a)	6,1	4,4	2,2	5,3	4,9	1,6
- EC-9	3,8(a)	6,6	11,0	8,6	13,1	12,2	9,3

(a) 1961-1967

Sources : Eurostat and Commission staff

Table II.5 : Variability of inflation rates, 1968-1980

Percentage points

	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
Deviation of change in consumer prices from annual average changes (a)													
- United Kingdom	-2,2	-1,1	-0,7	1,9	-0,1	1,9	1,8	8,0	0	-0,4	-6,6	-3,0	0
- Federal Republic of Germany	-2,8	-2,3	-0,5	1,4	1,0	3,0	2,2	1,2	-0,4	-0,7	-1,8	-0,7	0,5
- EC-10	-2,4	-1,0	-0,7	0,9	0,6	2,7	2,3	1,9	-0,3	-0,7	-3,2	-1,0	1,3
Deviation of change in per capita compensation of employees from annual average changes(1)													
- United Kingdom	-3,1	-3,8	2,1	0,5	2,1	2,2	0,8	12,9	-3,3	-7,4	-4,2	-1,7	2,9
- Federal Republic of Germany	-4,4	-1,6	4,3	0,9	-1,4	1,7	4,7	0,4	0,4	-0,8	-2,0	-1,7	-0,9
- EC-9	-3,3	-2,0	2,0	0,5	-0,2	3,0	3,2	3,8	-0,4	-2,4	-3,0	-2,2	0,9

(a) Averages relate to periods 1968-73 and 1974-80; see Table II.4.

Source : Commission staff

— 26 —

Table II.6 : Inflation and its components, 1976-1980

Percentage change over previous period

	1975 weights	1973	1974	1975	1976	1977	1978	1979	1980	1980 (quarters)			
										I	II	III	IV
Price of total final expenditure	100	10,0	20,6	23,8	16,3	14,0	9,0	13,3	16,9	4,6	4,0	2,9	2,1
Contributory factors													
Income from employment	50,9	15,7	19,3	30,5	13,0	8,5	12,9	15,9	23,3	5,1	7,3	6,5	4,9
Net taxes on expenditure	7,8	0,4	0,5	25,2	21,2	28,7	5,6	26,6	23,6	1,2	14,7	-5,1	4,7
Gross profits net of stock appreciation and other factor incomes (including residual error)	19,6	-6,1	12,4	18,9	16,6	22,0	8,6	6,9	5,5	11,8	-5,1	2,0	-6,1
Import costs	21,7	24,0	41,9	13,6	22,0	13,9	2,9	8,4	9,0	-1,2	-0,8	-1,2	0,4

Note : The top line shows the percentage change in the price deflator for total final expenditure and is the weighted sum of the changes in the four component parts set out in the subsequent lines of the table.

Source : Commission staff.

Table II.7 : Manufactured goods : indicators of export performance, 1960-1980

Table II.7(i) : Shares in the value of world trade in manufactures

Percentages

	1960	1965	1970	1975	1977	1978	1979	1980	1980 (quarters) I	II	III	IV
United Kingdom	15,0	12,4	9,7	8,4	8,4	8,6	8,8	9,2	9,4	9,2	9,3	9,0
F.R. of Germany	17,4	17,6	18,1	18,4	18,8	18,7	18,8	17,9	19,0	17,9	17,9	16,8
EC-9	55,7	55,4	53,2	53,8	53,8	54,3	55,5	53,8	56,4	54,5	53,2	51,6
Japan	6,2	8,6	10,7	12,3	14,0	14,1	12,3	13,3	11,4	12,9	14,4	14,6
USA	22,3	19,2	17,4	16,4	14,7	14,1	14,5	15,4	15,0	15,8	15,6	15,2

Table II.7(ii) : Volume growth of manufactured exports

Indexes 1975 = 100

	196C	1965	1970	1977	1978	1979	1980	1980 (quarters) I	II	III	IV
1. United Kingdom	51	59	78	115	115	117	118	125	120	110	115
2. F.R. of Germany	30	44	79	117	121	133	135	139	136	119	137
3. EC-9	31	44	75	117	123	131	133	138	135	119	135
4. Developed market economies	29	43	72	117	123	130	137	137	138	127	142
1/4	1,75	1,37	1,08	0,98	0,93	0,90	0,86	0,91	0,87	0,87	0,81
2/4	1,03	1,02	1,10	1,00	0,98	1,02	0,99	1,01	0,99	0,94	0,96

Source : U.N., Monthly Bulletin of Statistics.

Table II.8 : Indicators of import performance, 1962-1980

Table II.8(i)

Percentages

Manufactured goods : ratio of imports to total home demand	1970	1973	1975	1977	1978	1979	1980
- Manufactures, of which :	16,6	21,4	22,0	24,1	24,7	25,7	25,4
. Chemicals	18,0	22,0	23,0	27,0	29,0	30,0	29,0
. Mechanical engineering goods	19,0	26,0	27,0	29,0	30,0	31,0	32,0
. Vehicles	12,0	18,0	22,0	25,0	26,0	30,0	30,0
. Clothing and footwear	11,0	23,0	26,0	34,0	36,0	41,0	39,0

Table II.8(ii)

Percentage

Growth of trade in manufactured goods	Annual average 1962-1967	Annual average 1968-1977	1978	1979	1980
F.R. of Germany					
- Exports	9,1	10,9	4,1	6,5	4,0
- Imports	12,0	14,7	7,4	10,0	1,8
- Resource shift (a)	-2,7	-1,7	-3,1	-3,2	2,2
United Kingdom					
- Exports	2,8 (b)	9,7	0,8	0	0,9
- Imports	11,0 (b)	14,7	12,4	14,7	-1,3
- Resource shift (a)	-6,3 (b)	-2,3	-10,3	-14,7	2,2

(a) Change in ratio of export volumes to import volumes.

(b) 1964-1967

Sources : British Business, Monthly Digest of Statistics; Statistisches Bundesamt, Wiesbaden, Aussenhandel (Fachserie 7, Reihe 1).

Table II.9 : Balance of payments, 1958-1980

	Annual average 1958-1967	Annual average 1968-1973	Annual average 1974-1980	1979	1980	Forecast 1981	Forecast 1982
Volume growth of exports of goods (%)							
- United Kingdom	3,0 (a)	9,3	4,5	3,4	1,7	-4,7	1,6
- F.R. of Germany	9,0 (b)	12,6	5,9	6,5	5,4	6,0	8,5
Volume growth of imports of goods (%)							
- United Kingdom	6,2 (a)	9,4	1,4	11,3	-5,2	-6,2	4,0
- F.R. of Germany	8,7 (b)	15,2	8,7	11,7	5,3	-1,5	3,8
Balance of trade in goods							
- as % of GDP							
. United Kingdom	-0,8	-1,2	-1,8	-1,8	0,5	0,4	-0,3
. F.R. of Germany	2,9 (c)	2,6	2,1	1,1	1,2	2,0	3,0
Current account of balance of payments							
- as % of GDP							
. United Kingdom	-0,1	0,2	-1,2	-1,2	1,2	1,2	0,5
. F.R. of Germany	0,8	1,1	0,6	-0,7	-1,8	-1,4	-0,3

(a) 1963-1967

(b) 1961-1967

(c) 1960-1967

Sources : Statistisches Bundesamt, Volkswirtschaftliche Gesamtrechnungen, Fachserie 18 and CSO, Economic Trends.

(5)

Table II.10 : Area analysis of U.K. trade, 1965-1980

Percentages

	Exports							Imports						
	1965	1970	1975	1977	1978	1979	1980	1965	1970	1975	1977	1978	1979	1980
EC-9	26,3	29,6	32,3	36,6	37,8	43,1(a)	43,4(a)	23,6	27,2	36,4	38,4	40,5	44,6(a)	41,3(a)
Rest of Western Europe	15,6	16,8	16,8	16,8	15,3	13,7	14,3	12,2	14,4	14,7	15,1	17,1	15,3	14,6
North America	14,8	15,2	11,8	11,5	11,4	11,8	11,3	19,6	20,5	13,3	13,4	13,1	13,2	15,0
Other developed	14,8	11,9	9,4	6,3	6,3	6,1	5,7	11,9	9,5	7,9	7,3	6,9	6,5	6,8
Oil exporting	5,6	5,8	11,4	13,1	12,8	9,1	10,1	9,8	9,1	13,5	10,3	8,5	6,9	8,8
Other developing	20,0	16,8	14,9	12,9	13,5	13,2	12,4	18,5	15,0	11,2	11,8	10,7	10,9	11,4
Centrally planned	2,9	3,9	3,4	2,8	2,9	2,9	2,8	4,4	4,3	3,0	3,7	3,2	2,6	2,1
Total	100	100	100	100	100	100	100	100	100	100	100	100	100	100
Memorandum item: UK balance of trade with the EC-9 (fob/cif)(b)								-0,1	-0,1	-2,4	-2,0	-2,5	-3,4	-0,1

(a) EC-10
(b) UKL '000 million
Source : Department of Trade, Overseas Trade Statistics

Table II.11 : The external position; indices of the sterling exchange rate, competitiveness and the terms of trade, 1975-1981

1975=100

	1975	1976	1977	1978	1979	1980	1980 (quarters)				1981 (quarters)		
							I	II	III	IV	I	II	III
Effective exchange rate for sterling	100	85,7	81,2	81,5	87,3	96,1	93,0	94,5	96,7	100,2	101,8	97,8	90,6
Price competitivity of UK manufactured exports (a)	100	95,4	99,2	103,0	111,9	131,0	122,0	127,5	132,1	143,4	149,4	147,9	140,4
Ratio of export to import prices (terms of trade) 1975 = 100	100	97,9	100,2	105,9	106,3	103,8	101,1	103,4	105,5	105,2	:	:	:
Memorandum item													
Volume of North Sea oil production m.tonnes	1,6	121,7	382,7	540,1	778,6	804,7	204,3	191,1	204,1	211,3	219,5	217,4	:

(a) A rise in the index implies a loss of competitiveness.

Source : CSO : Balance of payments statistics and estimates of Commission department

Table II.12 : Value of UK exports of SITC sections 5 to 8 to selected markets as % share of those countries' imports, 1970-1980

%

UK Exports to	S.I.T.C. Section 5 (Chemicals etc.)					S.I.T.C. Section 6 (Manufactured goods)				
	D	F	I	USA	JAPAN	D	F	I	USA	JAPAN
1970	4,6	6,4	6,0	7,6	7,5	4,3	3,7	5,1	6,6	4,7
1971	4,5	5,8	5,7	8,1	8,2	3,9	4,0	4,7	6,6	6,1
1972	4,5	5,9	5,6	8,8	8,5	3,7	4,0	4,8	6,8	5,5
1973	5,1	6,0	5,3	8,1	6,3	3,8	3,7	4,9	7,3	4,4
1974	6,1	6,8	4,7	7,2	5,5	4,1	4,0	4,6	5,7	4,4
1975	5,6	7,2	5,7	5,6	5,4	4,2	4,2	4,6	4,4	4,4
1976	6,4	7,7	5,8	10,1	5,1	4,4	4,9	5,2	4,3	3,2
1977	6,4	7,7	6,1	10,5	5,3	5,1	5,1	5,4	4,5	3,5
1978	6,7	7,4	6,7	:	5,6	4,8	5,2	5,7	:	4,2
1979	7,9	7,7	6,6	10,2	4,6	5,3	5,2	5,6	4,2	3,8
1980	7,7	7,4	7,0	9,7	4,3	5,2	4,9	5,7	4,1	3,4
	S.I.T.C. Section 7 (Machinery and vehicles etc.)					S.I.T.C. Section 8 (Miscel. manuf. goods)				
1970	7,9	8,3	7,6	6,5	5,6	4,2	6,1	6,1	6,1	9,0
1971	7,6	8,2	8,0	6,0	5,7	3,8	5,2	6,5	5,9	8,4
1972	7,2	8,7	7,0	6,3	5,8	3,2	5,5	6,0	6,0	6,4
1973	7,1	7,6	6,7	6,5	6,8	3,4	5,4	4,9	5,6	4,4
1974	6,8	8,4	7,2	5,6	6,0	3,4	5,3	5,5	5,3	3,8
1975	7,2	8,8	7,4	6,6	7,4	3,5	5,8	6,3	5,1	4,9
1976	7,2	8,3	7,0	5,3	5,7	3,5	5,6	7,0	4,4	3,8
1977	7,6	8,2	8,0	4,7	7,1	4,0	6,4	7,2	4,1	4,2
1978	7,8	7,8	7,8	:	6,3	4,3	6,6	8,0	:	3,7
1979	8,5	8,4	7,7	5,2	5,4	4,3	6,4	8,7	3,8	3,5
1980	9,1	7,7	7,4	5,6	7,2	4,9	6,8	9,2	3,9	4,1

Source : OECD, Foreign Trade Statistics, series B and C.

Table II.13 (a) : Net balance of payments transactions on oil and related items, 1973-1980

UKL '000 million

	1973	1974	1975	1976	1977	1978	1979	1980	1981
Net exports of crude oil(deficit-)	-0,9	-3,4	-3,1	-3,9	-2,8	-2,0	-0,8	0,1	2,3
Other current account entries associated with the North Sea programme (deficit-)									
- imports of goods f.o.b.	-0,1	-0,1	-0,3	-0,5	-0,5	-0,2	-0,2	-0,2	-0,2
- net imports of services	-0,1	-0,2	-0,5	-0,6	-0,7	-0,5	-0,5	-0,5	-0,5
- interest profits and dividends	-	-	-	-	-0,6	-0,7	-1,3	-1,5	-2,0
Oil balance of payments on current account (deficit-)	-1,1	-3,7	-3,9	-5,0	-4,6	-3,4	-2,8	-2,1	-0,4
Related capital account flows (surplus+)	0,1	0,2	0,9	1,1	1,5	0,8	0,7	0,5	:
Total (deficit-)	-1,0	-3,5	-3,0	-3,9	-3,1	-2,6	-2,1	-1,6	-0,4
Memorandum items :									
United Kingdom : Oil balance of payments deficit on current account as % of GDP	1,4	4,5	3,7	4,0	3,2	2,1	1,5	0,9	0,2
France — Crude oil imports (cif) as % of GDP	1,4	3,8	2,9	3,3	3,1	2,5	3,0	4,0	:
F.R. of Germany — Crude oil imports (cif) as % of GDP	1,0	2,3	1,9	2,1	2,0	1,6	2,1	3,0	:

(a) This table is taken from the article "North Sea oil and the British Economy in European Economy No. 8, page 89 (English language version).

Sources : UK Balance of Payments : HMSO, Overseas Trade Statistics; International Financial Statistics, IMF; 1980 and 1981: Estimates of Commission staff.

Table II.14 : Balance of payments : Analysis of capital transactions, 1970-1980[a]

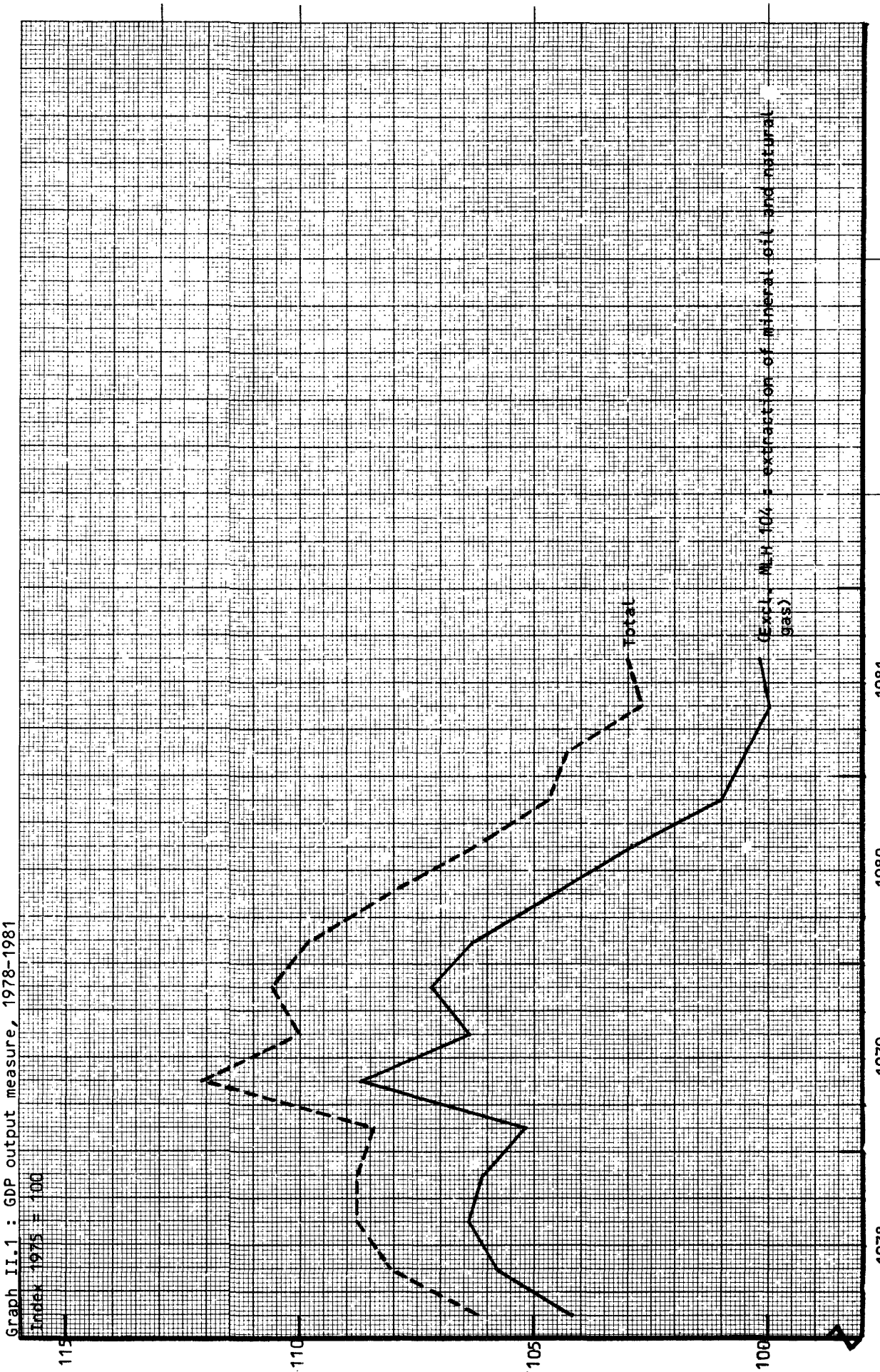
UKL '000 million

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
Current balance	0,8	1,1	0,2	-1,0	-3,3	-1,5	-0,9	0	0,9	-0,9	3,2
Capital transfers	0	0	0	-0,1	-0,1	0	0	0	0	0	0
Capital transactions											
Overseas investment in UK	0,7	1,0	0,8	1,5	2,2	1,5	2,1	4,4	1,9	4,3	4,6
of which: British government stocks	0	0,1	0,1	0	0,1	0	0,1	1,0	0	0,9	0,6
Total UK private investment overseas	-0,8	-0,9	-1,4	-1,8	-1,1	-1,4	-2,3	-2,3	-4,6	-6,6	-6,9
Official long-term capital	-0,2	-0,3	-0,3	-0,3	-0,3	-0,3	-0,2	-0,3	-0,3	-0,4	-0,1
Net export credit	-0,4	-0,2	-0,2	-0,2	-0,7	-0,5	-1,1	-0,3	-0,6	-0,8	-1,1
Foreign currency borrowing/lending abroad by UK banks	0,5	0,5	0,5	0,5	-0,3	0,3	-0,1	0,4	-0,4	1,6	2,2
Exchange reserves in sterling	0,2	0,7	0,3	0,2	1,4	-0,6	-1,4	0	-0,1	0,8	1,2
Other external liabilities in sterling	0,3	0,7	-0,1	0	0,1	0,6	0,3	1,5	0,3	2,6	2,6
External sterling lending by UK banks	0,1	0	-0,2	0	0,1	0,1	-0,3	0,1	-0,5	0,2	-2,5
Other transactions	0,2	0,7	-0,7	0,4	0,2	0,3	0,3	3,9	2,3	1,1	-1,8
Total official financing	-1,4	-3,3	1,1	0,8	1,6	1,5	3,6	-7,4	1,1	-1,9	-1,4
of which change in reserves	-0,1	-1,5	0,7	-0,2	-0,1	0,7	0,9	-9,6	2,3	-1,1	-0,3

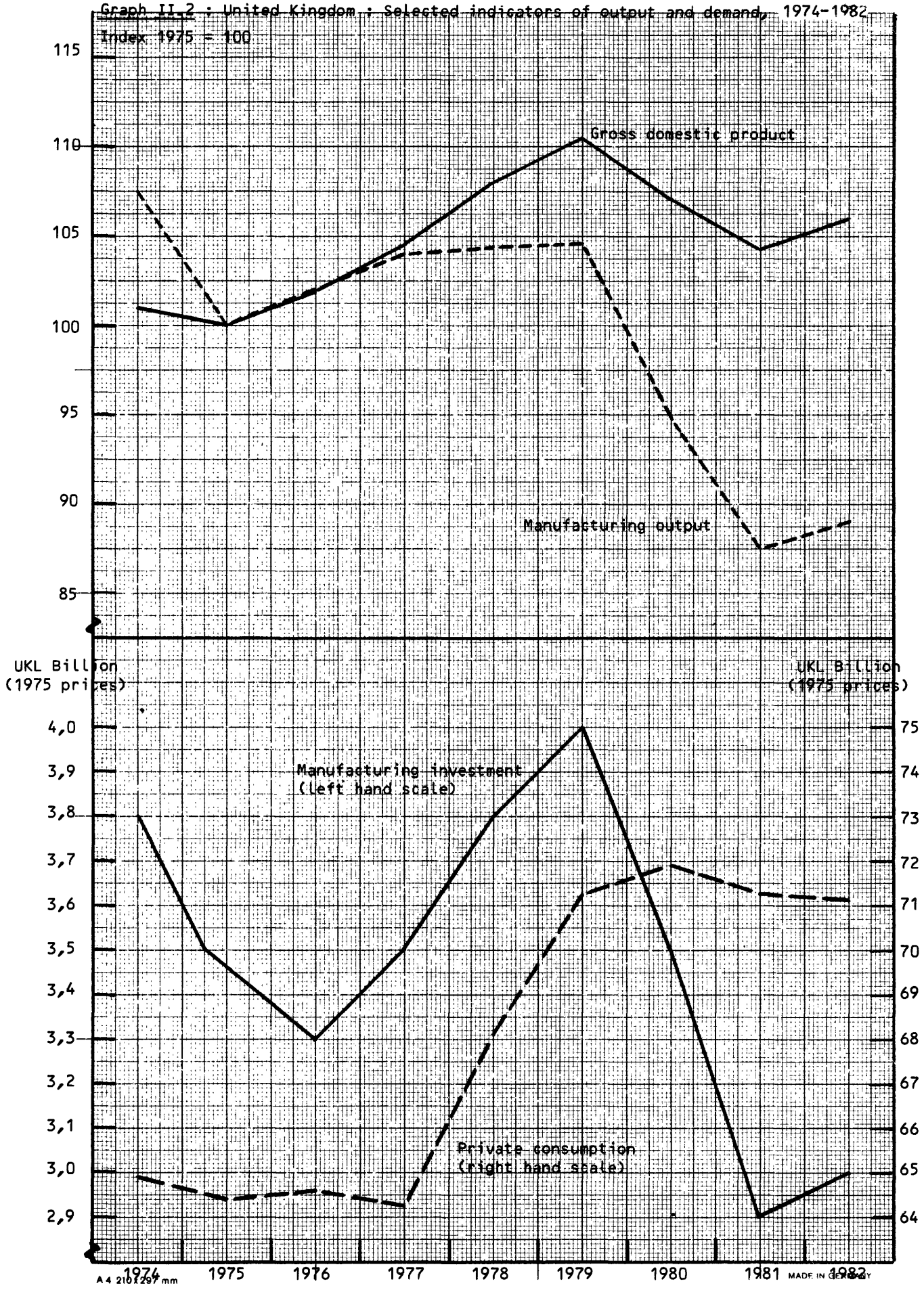
(a) Assets increase-/decrease+. Liabilities increase+/decrease-.

Source : CSO, Balance of Payments Statistics.

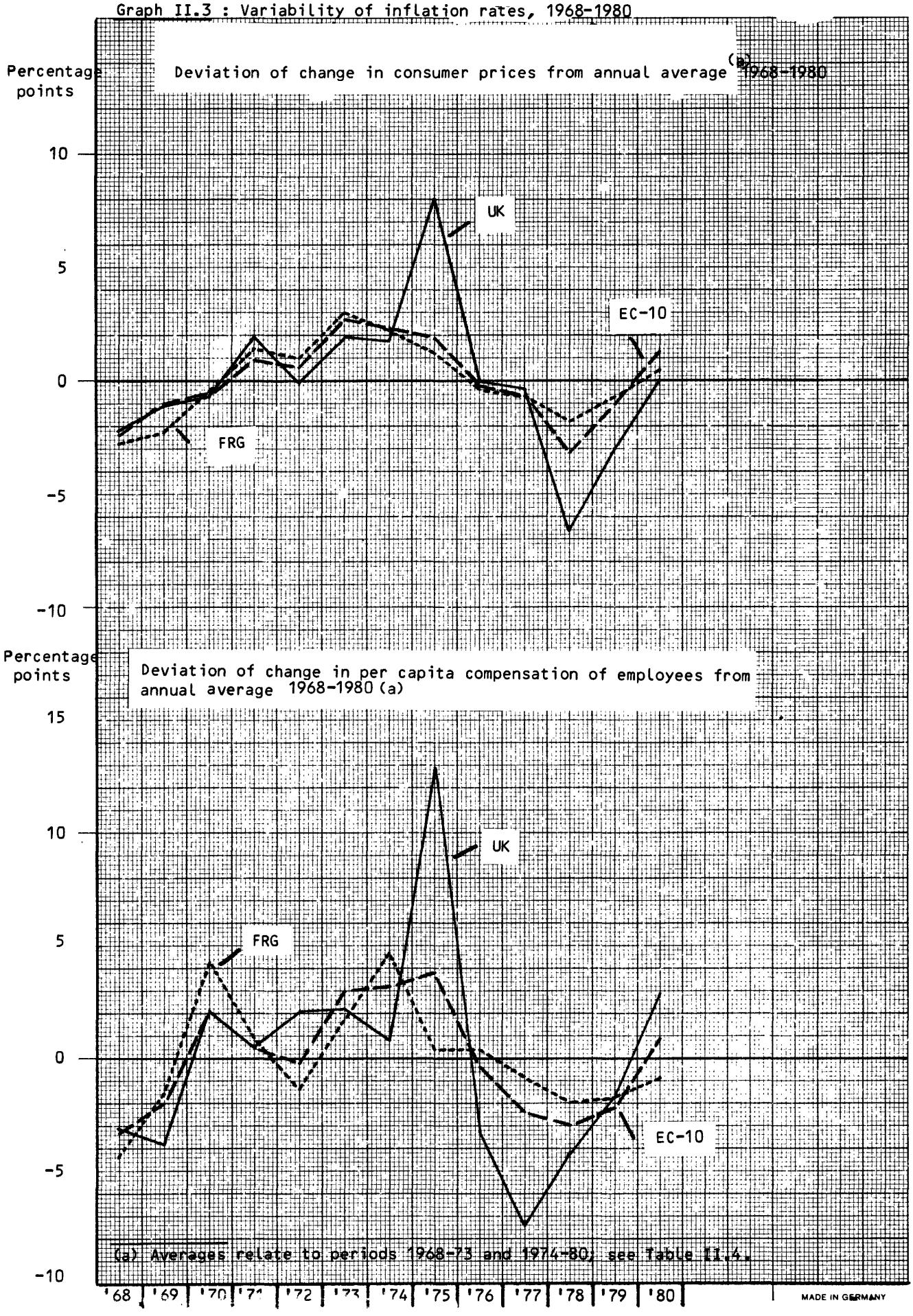
Graph II.1 : GDP output measure, 1978-1981



Graph II.2 : United Kingdom : Selected indicators of output and demand, 1974-1982



Graph II.3 : Variability of inflation rates, 1968-1980



(a) Averages relate to periods 1968-73 and 1974-80; see Table II.4.

III. THE MEDIUM TERM OUTLOOK

An assessment of the medium term prospects for the UK economy must draw upon the three major points made in Chapter II. Thus :

- On the output side the emergence of the UK as a producer of crude oil, and the appreciation of sterling, together with the marked move into recession in 1980 and 1981, has led to a significant change in the UK's structure of production, with manufacturing output and employment falling sharply. At the same time there has been a rise in consumption but a sharp decline in investment.
- Although since mid-1980 inflationary pressures have eased it is too early to ascertain whether there will be a further substantial reduction in the rate of wage and price inflation, especially as the sterling exchange rate is unlikely to be as strong as in 1980.
- Crude oil production, an improvement in the terms of trade, destocking and vigorous volume growth of manufactured exports (due to earlier sterling depreciation), all benefited the balance of payments to 1980. However the loss of UK export price competitiveness from 1975 onwards has been substantial and the period of heavy destocking now appears to be ending and these developments suggest that the UK's external position may weaken somewhat in the period ahead.

A number of independant bodies produce medium term forecasts for the UK economy most of which assume that the present economic policy stance will be broadly maintained. A number of these forecasts are summarised in Tables III.1 to III.4. These forecasts show a wide range of possible outcomes.

Nevertheless the following tentative conclusions can be drawn from these unofficial projections.

With regard to output :

- although in 1981 GDP is expected to fall very sharply there is no general consensus for a recovery in 1982; indeed some forecasters foresee a further fall in output;
- the majority view is that a recovery is to be expected in 1983 or 1984 although output growth is foreseen to slow down again in 1985.

With regard to inflation :

- the general consensus is that, in the longer term, the Government's policies will be successful in reducing inflation so that over the period to 1985 the annual increase in consumer prices should have fallen to below 10 %.

With regard to the balance of payments :

- estimates of the likely trends in the current account differ widely. On balance, however, a substantial deterioration is suggested.

With regard to unemployment :

- the forecasts of unemployment (excluding school leavers) show a wide difference in views ranging from a predicted level of 2,7 million to 4,3 million at the end of 1985.

As noted these forecasts are based upon the assumption that the broad thrust of the UK Government's present monetary and fiscal policies will be maintained. These policies have been established within the framework of the Medium-Term Financial Strategy (MTFS) (Financial Statement and Budget Report 1980-81, March 1981) which gives expression to the view that :

- growth and employment prospects in the UK will only improve if there is a permanent reduction in the rate of inflation and if the growth of the public sector is restrained;

- the key to achieving lower rates of inflation is the gradual reduction in the growth of the money supply as broadly defined (sterling M3);
- a reduction in the public sector borrowing requirement (PSBR) makes the most important contribution towards reducing the growth of the money supply.

Consequently the MTFS sets down target growth ranges for the money supply falling from 6-10 % for the financial year 1981-82 to 4-8 % for the financial year 1983-84[9]. Associated projections for a reduction in the PSBR, as a percentage of GDP, are also given, and these in turn are based upon forecasts of general government expenditure and receipts. Details of these targets and the recent development of the target variables are set out in Table III.5 and Graph III.1

The published MTFS is not accompanied by a detailed medium term forecast for the UK economy, but an indication is given of official thinking with regard to output growth. In particular the MTFS is based upon the assumption that GDP growth, in the three years to 1983, will average 1/2 % per annum, which implies growth rates of 1 3/4 % in both 1982 and 1983, following an official forecast of a fall in output of 2 % in 1981. This figure representes a modest downward revision to the previous assumption of 1% for average GDP growth to 1983,published in an earlier version of the MTFS(Financial Statement and Budget Report 1979-80, March 1980).

The medium term outlook for the UK appears to be less satisfactory than for other member countries of the European Community, particularly with regard to growth (see Table III.1). The following sections of this paper will attempt to establish why the UK's performance is likely to be relatively weak.

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(9) Strictly speaking there is a target for sterling M3 in the year ahead only; other MTFS figures are considered as illustrative ranges.

Table III.1 : A comparison of medium term forecasts for GDP growth, 1981-1985

	Percentage growth rate of GDP in volume terms					
	1981	1982	1983	1984	1985	Annual average
Forecasting body :						
National Institute of Economic and Social Research (a)	-3,1	0,6	1,4	2,1	1,5	0,6
Cambridge Economic Policy Group(b)	-3,4	-2,9	-1,7	-1,2	-1,1	-2,0
The St. James Group (c)	-1,3(i)	0,6	1,3	:	:	:
London Business School (d)	-2,9(j)	1,7	2,8	1,8	1,7	1,0
Independant Treasury Economic Model (ITEM) Club (e)	-3,6	-1,8	1,2	2,8	1,6	0
Oxford Economic Forecasting Limited (f)	-2,4	0,7	2,2	2,7	2,2	1,1
Phillips and Drew (g)	:	:	:	:	:	0,3(k)
Liverpool Group (Professor Patrick Minford)(h)	:	:	:	:	:	3,0(l)
Quantitative projections prepared by Commission departments as background material for 5th medium-term programme						
UK	:	:	:	:	:	0,6
D	:	:	:	:	:	2,5
EC 10	:	:	:	:	:	1,9

(a) National Institute Economic Review : November 1981; base projection.
(b) Cambridge Economic Policy Review. Volume 7 No. 1. April 1981.
(c) The Economist. 24 October 1981.
(d) Economic Outlook Vol. 6, No. 1 : The London Business School - Centre for Economic Forecasting. October 1981.
(e) The Guardian. 19 October 1981.
(f) Preliminary Medium Term Forecast : October 1981.
(g) Phillips and Drew Economic Forecasts. February 1981.
(h) Financial Times. 7 July 1981.
(i) Average estimate of GDP.
(j) Output estimate of GDP.
(k) 1980-85. (l) 1982-84.

Table III.2 : A comparison of medium term forecasts for price inflation, 1981-1985

Annual percentage changes

	1981	1982	1983	1984	1985	Annual average
Forecasting body :						
National Institute of Economic and Social Research	11,9	10,6	8,8	6,5	6,7	8,9
Cambridge Economic Policy Group	13,7	11,3	9,8	9,2	8,7	10,5
The St. James Group	12,0	13,4	11,1	:	:	:
London Business School	11,2	10,8	10,5	10,9	8,9	10,5
Independant Treasury Economic Model (ITEM) Club	12,3	14,4	7,3	6,1	7,4	9,5
Oxford Economic Forecasting Limited	12,0	10,4	8,3	8,0	8,9	9,5
Phillips and Drew	:	:	:	:	:	11,7 (a)
Liverpool Group (Professor Patrick Minford)	:	6,5		4,0 (b)	:	:

(a) 1980-1985

(b) Average 1983 and 1984

Sources : See Table III.1

Table III.3 : A comparison of medium term forecasts for the current account of the balance of payments, 1981-1985

UKL billion

	1981	1982	1983	1984	1985
Forecasting body :					
National Institute of Economic and Social Research	2,1	1,8	3,7	2,2	0,6
Cambridge Economic Policy Group	1,7	0,6	:	:	-9,0
The St. James Group	4,1	-0,2	-0,2	:	:
London Business School	5,2	1,6	1,5	2,8	4,0
ITEM Club	5,5	-6,9	-7,4	-8,0	-5,4
Oxford Economic Forecasting Limited	5,7	0,9	-0,2	-1,5	-1,7
Phillips and Drew			-0,6 (a)		

(a) Average current account deficit 1980-1985.

Sources : See Table III.1

Table III.4 : A comparison of the medium term forecast for unemployment 1985 (a)

millions

Forecasting body :	
National Institute of Economic and Social Research	3,7
Cambridge Economic Policy Group	4,3
The St. James Group	2,75 (b)
London Business School	2,7
ITEM Club	3,6
Oxford Economic Forecasting Limited	2,7
Liverpool Group	2,75 (c)

(a) UK wholly unemployed excluding school leavers, unless otherwise stated.
(b) First half 1984.
(c) 1982

Table III.5 : Monetary targets, sterling M3 growth and the public sector borrowing requirement (PSBR) 1972/73 - 1983/84

Financial years	Target growth rate for sterling M3 (%)	Actual growth rate of sterling M3 (%)	Target PSBR as in MFTS (a) as a % of GDP (b)	Actual PSBR as a % of GDP
1972 - 1973		25,2		3,8
1973 - 1974		23,5		6,0
1974 - 1975		8,5		9,1
1975 - 1976		6,9		9,6
1976 - 1977	9 - 13 (c)	7,6 (c)		6,6
1977 - 1978	9 - 13	15,5		3,7
1978 - 1979	8 - 12	11,4		5,5
1979 - 1980	7 - 11 (d)	12,5	4,75	4,9
1980 - 1981	7 - 11	18,4	3,75	5,7
1981 - 1982	6 - 10 (a)		4,25 (a)	(4,4) (e)
1982 - 1983	5 - 9 (a)		3,25 (a)	
1983 - 1984	4 - 8 (a)		2,0 (a)	

(a) Budget, 10 March 1981, Medium-Term Financial Strategy.

(b) In constant price terms.

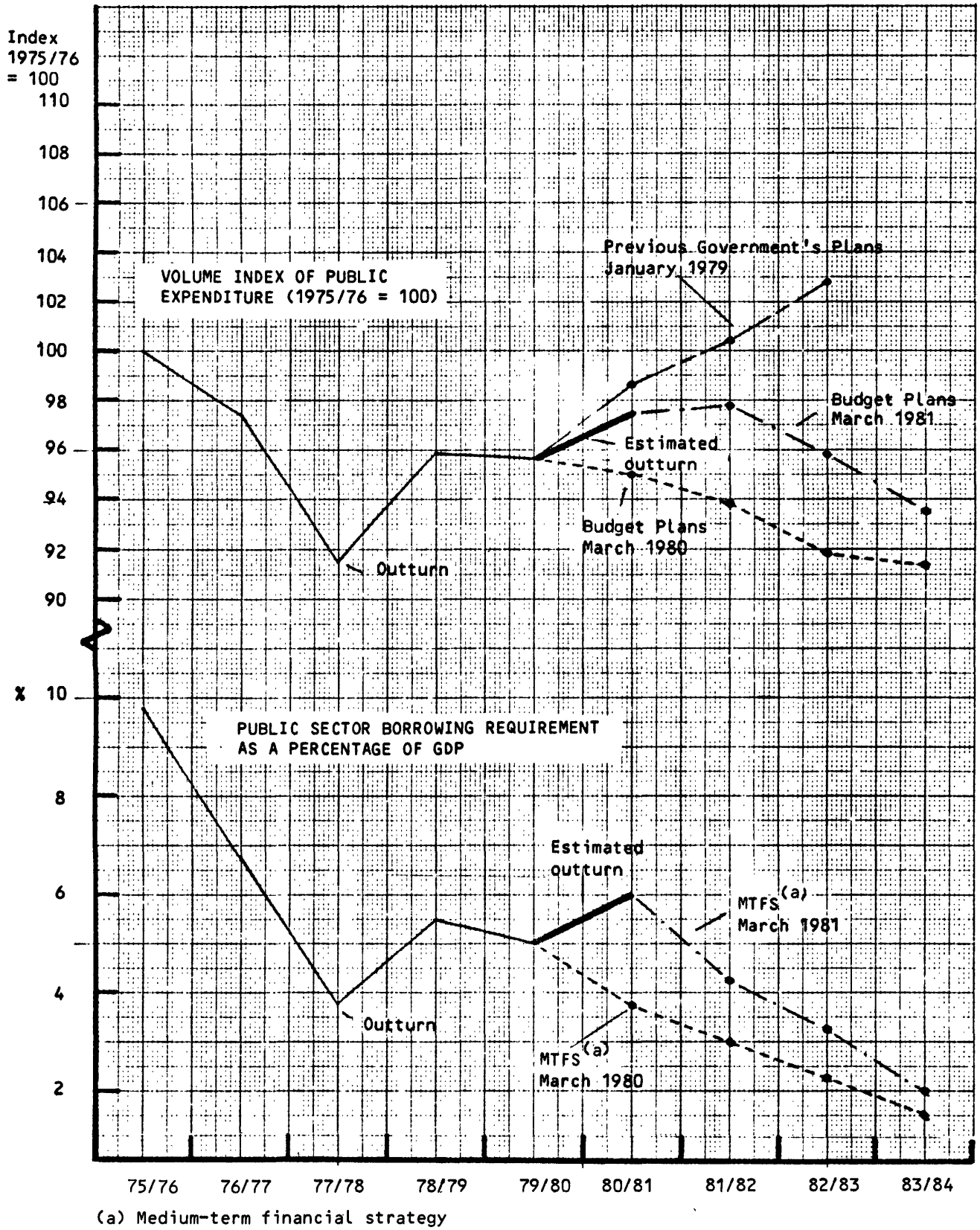
(c) M3

(d) From June 1979

(e) DG II forecasts

Sources : HMSO, Financial Statement and Budget Report; 1981-82, Bank of England Quarterly Bulletin; Commission staff.

Graph III.1 : UK public expenditure and public sector borrowing requirement 1975/76 - 1983/84



(a) Medium-term financial strategy

Sources : HMSO, Financial Statement and Budget Report, 1981-82 : "The Government Expenditure Plans 1981-82 - 1983-84 (Cmnd 8195).

IV. MAIN MEDIUM-TERM ECONOMIC ISSUES

Investment and productivity

Investment share

One of the most often quoted reasons for the UK's weak growth performance is the relatively low proportion of GDP which is devoted to investment expenditure and its consequences for productivity growth. As Table IV.1 shows, over the years investment has formed a smaller part of GDP in the UK than in most other industrialised countries. However it is much more difficult to judge to what extent this has accounted for the lower growth rate, is itself the result of the lower growth rate, or represents socio-economic factors peculiar to the UK.

In terms of aggregate investment the evidence is clear : between 1973 and 1980 an average 18,8 % of GDP was devoted to investment expenditures compared with 21,4 % in the Community as a whole, maintaining the relative positions evident since the mid-fifties. An examination of Table IV.2, which gives a sectoral breakdown of gross fixed capital formation in terms of GDP, shows however that the UK's performance is not equally weak in all areas of economic activity. In particular over the years to 1978 investment in the UK's manufacturing sector has been maintained at around 3,5 % (10)of GDP while in the Community (11) (12) as a whole a decline in this share to around the same level

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(10) Some fall off in investment by manufacturing companies (due mainly to cyclical factors) was evident in the UK in 1980. Data on the comparative position in the Community as a whole is not yet readily available.

(11) Excluding DK, GR, IRL and L

(12) These comparisons ignore the effect of increased leasing of capital goods from the service sector.

has been evident since the first oil shock. The effect of investment related to the exploitation of North Sea oil is shown by the larger share of UK GDP devoted to the energy and mining sector in recent years. Aggregating these two sectors shows that the UK has committed a larger share of GDP to industrial investment than is the case in either the Community or in the Federal Republic of Germany. It is in the service and general government sectors that, in proportional terms, the UK has invested fewer resources.

Splitting total capital expenditure into equipment and construction expenditures reveals that, prior to 1973, the UK invested as great a share of GDP in equipment as in the Community as a whole, and has since then, partly because of North Sea oil, invested at much the same rate as the Federal Republic of Germany (approximately 9 %), somewhat above the Community rate. Expenditure on building in terms of GDP is markedly less in the UK than in the rest of Europe, running some four percentage points below the average figure, while within this category the UK devotes only approximately 3,5 % of GDP to housing compared to about 5,5 % in the Community.

This brief consideration of the sectoral breakdown of UK investment suggests that it is too simplistic to attribute the UK's poorer industrial performance to the overall share of investment in GDP.

The lower growth rates experienced in the UK (see Chapter II) have meant that, although in some sectors the commitment of resources in terms of GDP has matched that in faster growing economies, the absolute increment to the capital stock has been significantly smaller. If replacement rates have been no greater in the UK (13) then this means that a smaller portion

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(13) This certainly seems to have been the case.

of the overall capital stock will embody the latest technology with attendant consequenses on the level of productivity of the economy and, over time, on its sustainable rate of growth. This reasoning suggests that a sustained increase in the rate of growth of investment expenditures is required to improve the overall performance of the UK economy rather than just a step increase in the share of national resources devoted to investment.

Determinants of investment

Although the subject of considerable research efforts, there is no universally accepted model of the determinants of private investment expenditure. There is however, a wide area of agreement over the variables that are likely to influence investment if not on the size of their effects. Expenditure on capital goods is crucially dependent on their prospective yields : a number of inter-related factors will enter the ex-ante judgment of a project's viability. These include :

- the current rate of profit on similar projects
- the availibility of finance and the (opportunity) cost of capital set by the future (uncertain) rates of return in other forms of investment
- the likely future conditions of demand and their influence on the projects profitability.

An assessment of the UK's investment performance must therefore examine the evolution of these factors and contrast their behaviour with the experience elsewhere.

As Table IV.3 shows, on a pre-tax basis the real rate of return (14) on capital employed (excluding North Sea oil activities) has fluctuated around a declining trend from nearly 11 % in the mid-1960's to only 3 % in 1980, with large step falls evident in 1974 and 1980, while data for the first quarter of 1981 show a further fall to around 2 %. On a post-tax basis (Bank of England Quarterly Bulletin, June 1981) the real rate of return lay between 5,5 % and 8 % with the exceptions of 1975 and 1980 when it was between 3 % and 4 %. For manufacturing industry alone the pre-tax rate of return has shown very similar movements to that for the aggregate measure but has been consistently about one percentage point below the aggregate level. Moreover as Graph IV.1 shows there seems to be a strong correlation between the rate of investment and the average rate of profitability in the previous year.

Although exact comparisons of the level of profitability across economies are difficult. Table IV.4 indicates that, since the 1960's at least, the UK has experienced a significantly weaker profit performance than other major industrialised nations and that in manufacturing its relative performance has declined markedly over the seventies, notwithstanding the general decline in profitability that seems to have occured since the late 1960's.

A number of factors have been advanced as playing a role in this secular decline. For example Manison (Manison, 1978) has pointed out that the sharp fall in manufacturing profits since 1973 has been partly due to the brunt of the adjustment to the

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(14) These are average measures and cannot be taken to indicate exactly the (marginal) rate of return on new investment. Furthermore the accuracy of these calculated average rates depends partly on the estimate of the value of the capital stock. If this value is overestimated due to insufficient allowance being made for economic obsolescence then the calculated rate of return will be underestimated.

first oil shock being borne by profits and not shared by real wages (15) while he argues that over the longer term low rates of labour productivity growth, below the rate of real wage growth in non-manufacturing, and an underlying decline in the marginal physical productivity of capital have also reduced the rate of return. Moreover the poor profits performance has reduced the capacity of companies to undertake new investment.

While the falling level of profitability has reduced the incentive to invest per se the real cost of capital appears to have moved in a way which partially offsets this decline. The relationship between the marginal profitability of capital and its marginal cost is proxied by the valuation ratio ('q'). This is calculated as the average post-tax real rate of return on existing assets to the post-tax real cost of capital and has exhibited a less strongly declining trend than the real rate of return. Nonetheless, as Graph IV.2 shows, it has been since the first oil shock below unity, at which level the costs and returns are equal, and is presently very close to its historically low level.

It has often been argued that the availability of external finance has acted as a constraint on the ability of firms to invest; however the Wilson Committee (HMSO, June 1980), which reviewed the functioning of British financial institutions, found that this was generally not the case, but with the notable exception of small firms, who can, in certain circumstances, face significant difficulties.

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(15) This movement seems to have been more pronounced in the UK than in the Community as a whole after the first oil shock while the UK experience after the second oil shock has been much nearer the average (European Economy, No. 10, December 1981, Ch. 4).

There is strong econometric evidence (16) to show that the level and rate of change of demand has a pervasive effect on the level of investment. To a large extent this is because profitability is dependent on the level and rate of growth of demand. Depressed demand conditions or a belief that any growth spurt will be short lived will undoubtedly have reduced the incentive to invest. This seems to have been the case in the UK over a long period of time where the stop-go cycles have now given way to a stagnation or decline in output. Moreover the loss of competitiveness caused by the appreciation of the exchange rate in conjunction with an inflationary wage round in 1979-1980 have put further pressures on company profitability.

Capital stock and potential output

The stagnation of investment expenditures since the first oil shock, will tend to have further increased the average age of the capital stock and reduced the rate at which technical innovations are embodied in the production process. Overlain on this process is the economic obsolesence of the existing capital stock induced by the step changes in the relative price of energy. Both these influences will have had detrimental effects on the level and growth of potential output in the UK.

Moreover, Manison (Manison, 1978) points out that even from the mid-60's there was a tendancy for the rate of investment in heavy manufacturing, with the notable exception of chemicals, to be below the average for manufacturing as a whole. Pratten (Pratten, 1971) and others (Maizels, 1963) have argued that it is in these industries that high output returns on new capital are most easily generated. Moreover a failure to invest in the technologically dynamic industries has tended to lead to an

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(16) An example of this type of work is to be found in Bean, 1979.

inability to supply a range (17) of finished manufactured goods in time of boom.

No recent estimates have been made of the potential output of the UK economy; however as Table IV.5 shows the gross capital stock in the UK has been showing a declining rate of growth since 1973 before any account is taken of the economic obsolesence of parts of the stock due to the energy price rises. For both these reasons typical techniques for assessing the full capacity output of the economy, such as peak to peak trend, are likely to be even more uncertain than usual. As pointed out by Robinson (Robinson, 1981) manufacturing output is currently only 6 % below trend if a five year moving average is used compared with 22% below if a linear trend for the period 1963-79 is fitted. Although this result does not translate easily to total output, since the other sectors of the economy tend to use energy less intensively than manufacturing, there is a clear message that the spare capacity in the UK economy is probably much below the level suggested by the traditional indicators.

Research and development

Expenditures on research and development have very uncertain returns but in cases where a successful innovation results the returns may be very high indeed. Graph IV.3 shows that the UK commits a similar proportion of GDP to R & D as other industrialised nations, albeit with a lower absolute level of expenditure. Moreover the public authorities fund a larger share of R & D in the UK, 32 % of the total in 1978 (UK Business Monitor, 1981). The strength of this public involvement in R & D is shown by Table IV.6 where in terms of GDP the UK's expenditure exceeds that of any other Community country. However the compo-

(17) Manison cites the shortages of steel, castings, electric motors, machine tools and diesel engines in 1973.

sition of this public expenditure differs greatly from the average with relatively small amounts being spent on energy, industry and general knowledge compensated by large defence expenditures which account for over 50 % of the total budget compared with 12 % in the Federal Republic of Germany and a Community average of 22 %.

This predominance of defence expenditures by the public sector is also demonstrated in Table IV.7 which shows a heavy concentration of industrial R & D expenditure on aerospace and electronics; however,the NEDO (NEDO, 1981) reports that the industrial spin-off from these activities is less than for comparable activities in other countries. In addition, in the areas, such as electrical machinery and chemicals, where the UK effort is relatively weak, there is little evidence that significant imports of new technology are being made. In sum this suggests that the technological foundation from which an improvement in the UK's investment performance can be made is not being laid either by domestic efforts or through the purchases of technology from abroad,although it must be noted that capital goods imports have grown quickly in recent years.

Productivity

Growth in total productivity, the amount of output which can be produced with a given level of factor inputs, varies across economies, between sectors and over time. As shown in Chapter II the UK has experienced low productivity growth throughout the last two decades. The more detailed comparison in Table IV.8 further demonstrates this point and shows a growth rate of labour productivity in the UK well below the Community average and Japan, though above the rates experienced in the USA. The more limited data on capital productivity (Table IV.9) shows a more complicated picture where the UK's performance has been better than that in the Federal Republic of Germany but worse than the Community average.

A second striking feature of the table is the dramatic slowing of labour productivity growth since the first oil shock, which has reduced the trend rate of labour productivity growth in all countries by one to three percentage points, with the exception of Japan, where the rate has fallen even more markedly.

Why the UK should suffer a lower rate of labour productivity growth than its international competitors is a problem to which a large number of commentators have addressed themselves. The preceding discussion in this section suggests that although the rate of investment in terms of GDP in the UK, especially in equipment, has not been much below that in faster growing competitors, the direction of this investment and its content of technical innovation has tended to generate smaller increases in output, resulting in turn in smaller gains in both labour and capital productivity than elsewhere.

In a wide ranging study, Caves (Caves, 1980) puts forward several reasons for the low productivity growth in much of UK manufacturing industry. These include long standing attitudes of the work force against change and cooperation, poor administrative capabilities of management which is particularly evident in large enterprises and above average diseconomies of scale in large plants.

The general decline in labour productivity growth rates in industrial countries since 1973 has often been ascribed to structural shifts following the increase in the relative price of oil (European Economy No. 9, July 1981). This view is countered both by Maddison (Maddison, 1979) and an OECD study (OECD, July 1979), which conclude that the slowdown is almost entirely attributable to cyclical factors. In particular, the OECD study notes that structural shifts in demand in the UK, the Federal Republic of Germany, France and Japan have in fact had a marginally positive effect on productivity growth both pre and post 1973.

It is difficult to assess to what extent the differences in demand conditions in the UK compared with its competitors have resulted in the UK's lower rate of productivity growth. It is, however, notable that the current recession has been associated with significant labour shedding and in recent months, as output has stabilised, this has led to a sharp improvement in productivity. It is too early to judge to what extent this improvement represents essentially a step change, caused by the closure of the least efficient plants and firms, or represents a lasting shift to a higher trend growth rate of productivity, as a consequence of improved attitudes.

Small firms

In recent years the role of the small enterprise in the growth and development of the economy has been the subject of new interest.

As part of supply based policies the small firm is seen as an area where entrepreneurial dynamism can be re-established. There is however little information on what proportion of new small firms, for whom conditions of external finance have been greatly improved in recent years, are capable of rapid growth and long life, nor are there any well developed economic theories which demonstrate how an improved macro-economic performance will automatically flow from the proliferation of small business, many of which will be in the service sector. It is nonetheless noteworthy that Department of Industry figures show that even with current economic difficulties approximately 10 000 new ventures are being established per month.

Conclusion

This section demonstrates, in contrast to a widely held view especially outside Britain, that the UK's investment performance is not uniformly weaker than in other countries. Indeed, as far as directly productive investment, particularly in the

manufacturing sector, is concerned the UK devotes a similar proportion of resources as elsewhere. It is the addition to output that this investment brings about that seems to be lower in the UK although it is difficult to pin down exactly why this should be the case. Factors that have been advanced to explain this performance include the system of education, the attitudes of management and labour, the discontinuities of policy and lack of concensus at both the national and company level.

Labour market trends and problems

Demographic trends

Since about 1974 the population of working age has increased rapidly. High birth rates in the 1960's increased the number of young people entering the workforce. At the same time the death rate of those of working age fell as did net emigration. These demographic trends will continue to have a major impact on the labour market over the next five years. They will be reinforced by a sharp decrease in the number of men and women reaching normal retirement age, 65 and 60 years respectively. Not until the middle of the decade will there be a temporary increase in the number of people reaching the age of 65 (18). Table IV.10(i) shows the change in the size of the population of working age for the period 1977/81 and the estimated change in the period 1981/86, at 732 000 and 762 000 respectively, a rate of increase of about 1/2 % per annum. The increases are concentrated among men and unmarried women and among younger people, that is, those groups for which activity rates are the highest.

Activity rates

Between 1971 and 1977 overall activity rates increased from 61,0 % to 62,2 % in spite of a decline in the rate for older males associated principally with a trend towards earlier retirement. This development, allied to the growth in the number of people of working age, tended to exacerbate unemployment levels and was mainly due to a steady increase in the female activity rate up to 1977. The increase was particularly big for married women (see Table IV.11). The introduction of equal pay, the increasing

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(18) These trends reflect lower birth rates during the years of the First World War, the post-war baby boom and the low level of births which persisted after 1920 for the remainder of the inter-war period.

acceptability of married women working, the growth of service industries and of part-time work opportunities, the decline in real average earning between 1976 and 1977 and the resultant desire to supplement family income were all factors which may have contributed to the increase in female activity rates. It should be noted that female activity rates in the UK are high relative to other countries of the Community; in particular rates for women in the 40-60 age brackets are 20 percentage points higher than the EC average (Table IV.12).

In the period 1977/81 a significant change occurred. The decline in the overall male activity rate accelerated sharply, and, in contrast to most other Community countries, the overall female activity rate ceased to rise and even edged downward (Table IV.11). The net result of the demographic trends and the changes in activity rates was that over the period 1971/77 1,1 million people entered the labour market but in the 1977/81 period there was a reduction of 140 000 despite a large increase in the population of working age (see Tables IV.10(ii) and (iii)). Consequently the rise in the unemployment in the last few years would have been even steeper, had the activity rates not fallen.

In the years to come, demographers (HMSO, Employment Gazette, April 1981) assume that activity rates, overall, will remain broadly unchanged. On this basis, in the period 1981/86, the labour force is expected to rise by 685 000, a substantial turnround from the fall that occured in the preceding 5-year period (Table IV.10(ii).

Voluntary unemployment

It is sometimes alleged that the supply of labour has been increasingly affected by the extent of voluntary unemployment and the degree to which people registered as unemployed are engaged in remunerative work in the informal economy. Generous levels of unemployment benefit are often cited as a major factor encouraging voluntary unemployment (OECD, 1981). Studies (eg Nickell, 1980)

on the effects of unemployment and related benefits on the level of unemployment noted however, that (i) the evidence available up to 1979 suggested the effect of higher unemployment benefits was of minor importance in influencing the flow into unemployment; (ii) the level of benefits affected the duration of periods of unemployment with the ratio between unemployment benefits and the expected wage having less of a weighting in unemployed peoples' decisions after 26 weeks unemployment; (iii) long periods of unemployment were due to a complex of factors such as age, family circumstances, skills and location.

No precise information is available on the effects of the informal economy. Recent estimates (Smith, 1981) of the global impact of the informal economy - accounting for between 2 and 7 1/2 % of GDP with associated tax losses of between UKL 3 and UKL 3 1/2 million a year - suggest that some involvement of the unemployed is likely.

Overmanning

In spite of much anecdotal evidence, it is extremely difficult either to define or pinpoint precisely overmanning in British industry. The built-in incentive for employers to hoard labour, particularly skilled labour, because of the high direct and indirect costs associated with redundancies, is well known; bad management practices and inflexible trade union attitudes are also often cited as factors but at best overmanning is a relative concept and its impact on the economy as a whole is dependent on the level of wages.

The following type of arguments have been used to suggest that the UK economy has a tendency to use labour inefficiently.

- The fall in UK output below the longer term growth trend established in the 1960's (15 % by 1979) was not proportionally reflected in the movement in employment (see Graph IV.4, lower part).
- An analysis by the Cambridge Economic Policy Group (Cambridge Economic Policy Review, April 1981) (see Table IV.13) compares

actual changes in employment with those predicted as a function of output; the results shown on the heroic assumption that if the relationship has held over the projection period then a level of recorded employment some 2 million lower might have been expected at the end of 1979.

- In the past government policies have often been geared to job preservation (see Table IV.14).

As the section on productivity showed, there have been sharp gains in labour productivity over the course of the present recession, particularly in manufacturing. To the extent that this has been due to labour shedding then this may indicate a change in behaviour away from the practices which led to overmanning.

Occupational change

Table IV.15 shows changes in employment per sector. The expansion of employment in the services sector was a marked feature of occupational change up to 1978, reflecting in part the strong growth in public sector employment in such services as education and health. Over the next few years it is likely that reductions in industrial employment will continue: engineering, textiles and clothing, transport and communications and distribution are particularly vulnerable areas. In general, there is a long-term occupational shift from manual to non-manual jobs; nearly one half of all jobs can now be classified as non-manual, while there remains a relatively fast growth in the demand for highly skilled labour in both manual and non-manual occupations.

Unemployment and its structure

Total unemployment rose from 1 302 000 in October 1979 to

2 744 000 in July 1981 (19). Movements in annual average unemployment rates in recent years are shown in Table IV.16(i) and a comparison with other EC countries is given in Table IV.16(ii). The situation in the UK is relatively serious, of the 9 million unemployed in the Community about one third are in the United Kingdom which also accounts for about 40 % of the unemployed adult males.

Further features in UK unemployment trends since the end of 1979 are :

- The worsening position of young people as shown in Table IV.17.
- That although job losses among general labourers and persons in other manual occupations accounted for over half the absolute rise in unemployment between end 1979 and early 1981, there has been a marked rise in job losses among craft workers (see Tables IV.18(i) and (ii)). Apparently, the widely held view that the risk of unemployment is low for skilled workers is not correct; some skills are becoming obsolete for structural reasons and others are not demanded as a result of the recession.
- The marked increase in the duration of unemployment for all age groups (see Table IV.19).
- The continued existence of both regional and geographical skill mismatches between the supply and demand for labour.

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(19) It is possible that the unemployment figures overstate the level of unemployment because of precautionary registration by people in the course of changing jobs and other factors. The Cambridge Economic Policy Group (Cambridge Economic Policy Review, April 1981) estimates this distortion at about 450 000 but points out that it is necessary to set against this figure the downward bias caused by discouraged workers leaving the labour force.

Supply side measures

(i) Work sharing and changes in working time

It is not clear whether deliberate generalised measures by Government to reduce working hours per man, such as limiting overtime and extending annual holidays, could be used successfully as a means of reducing unemployment. Experience of such schemes to-date has not been extensive enough to identify what the effect of such measures could be. There are a number of reasons, however, for believing that resultant job creation would be small and that in certain circumstances job losses may be provoked (Day, 1981).

As a means of work sharing, a reduction in the average retirement age would seem to have more scope in the UK since the activity rates for both men and women in the 60-64 age brackets are some 20 and 10 percentage points higher,respectively, than those for the Community as a whole. However the present structure of pension provision is such that the cost to Government of a comprehensive early retirement scheme would be considerable while private sector schemes would have great difficulty in accomodating such a change.

(ii)Regional mobility measures

Although UK unemployment rates have exhibited quite wide regional differences, even when viewed in the Community context, the migration of labour has tended to be on a smaller scale than has been the case, for example, in Italy.

The small scale mobility incentive schemes operated in the UK over the past decade do not seem to have been a major influence on migrants. A recent study (Beaumont, 1979) found that the employment transfer scheme in the UK had not affected the bulk of migrants; of those who were assisted under the scheme many would have moved anyway and others did not stay long in their new regions. The study also suggested that in any case

the social and economic costs of labour mobility were not high in the UK.

Given the continued existence of skill shortages (DE, September 1980, p. 102) in the South East and South of England even in recession there seems a prima facie case for some movement of skilled labour. However the bulk of assisted migrants in the past seem to have been unskilled or semi-skilled.

(iii) Vocational training

Government sponsored vocational training in the UK has never been on the scale encountered in the Federal Republic of Germany, where it is estimated that about 3 % of the total labour force participate yearly in further training measures (Hofbauer, 1981) and where some 60 % of the work force posses intermediate qualifications compared with 30 % in the UK. These differences are reflected in training methods. In the Federal Republic of Germany the emphasises is on formal training and examinations to obtain qualifications while in the UK the prevalent method has been on-the-job training over a number of years. Rapid technological and economic change which require the speedy absorbtion of transferable skills now gives the balance of advantage to the German system and other European countries are moving increasingly towards this vocational training (S.J. Prais, 1981). Furthermore there is currently a clear reluctance amoung employers to take on apprentices during a recession (Economic Trends, September 1980) and the number of craft and technician apprentices going into the engineering industry in 1981 was the lowest since records began (DE, September 1981). It is estimated that the industry's future needs would require 20 000 apprentices but the intake was less than 12 000.

In response to the problem of increasing youth unemployment the Government has recently announced a package of measures which are designed to alleviate this problem while also providing some basic training. These measures will ensure that school leavers who cannot find full time employment will be offered a place on a one year foundation course which will include both on and off the job experience. It remains to be seen, however, if these and the other existing employment schemes will substantially alter the problems of underemployment in the UK economy or provide a reserve of skilled labour which will prevent bottlenecks from appearing in an upturn.

Competitiveness and import penetration

The ability of domestic producers to compete on both the international and domestic markets is for a large part dependent on the price at which their production is profitable.Non-price factors also have a role to play but even when these are adverse a suitably low relative price will act as an offset in most cases.

Movements in relative exchange rates do not necessarily mirror movements in relative domestic price trends. An examination of both is required for the discussion of the level of competitiveness. While the exchange rate is immediately observable there is considerable debate over the most appropriate measure of relative price competitiveness (H.M. Treasury, February 1978). One possibility, used in Chapter II above,is relative prices. Another of considerable interest is the relative trends in costs. Such an indicator has the advantage of covering, for manufacturing industry, the costs of production for exporters and for companies facing import competition while it does not vary with the degree to which changes in costs are reflected in prices or profits. The comparison does however, tend to be based on movements in labour costs rather than total costs because of difficulties of measurement. Their reliability therefore depends on the homogeneity of other input prices across economies.

Table IV.20 shows the movements that have occurred in the effective exchange rate and relative unit labour costs measured in both national and common currency terms (20). On average prior to 1978 the faster growth of labour costs in the UK was more than offset by the depreciation of the exchange rate so that in 1977 relative unit labour costs in the UK measured in a common currency were some 11,6 % below their 1970 level. Since 1977 there has been a sharp deterioration in the UK's competitive

(20) These figures are calculated as a geometrically weighted average of the UK's competitors' exchange rates and unit labour costs.

position. The effective exchange rate appreciated by 17,6 % between 1977 and 1981 while at the same time relative unit labour costs rose by 34,2 % resulting in an increase in unit labour costs in foreign currency terms of 57,8 %. Although competitiveness has improved somewhat in 1981, the ground which must now be recovered or offset by non-price factors is still immense.

Research findings (Enoch, 1978), suggest that in the past there was a relatively long time lag between changes in price competitiveness and export performance (perhaps up to four years) but more recent evidence points to a shortening of this lag. The impact on imports is felt much more quickly. The current low levels of demand however mask the extent to which this loss of competitiveness is leading to increased import penetration (21) while the performance of exports, which have shown a remarkable buoyancy in the face of the recession in world trade, may not yet be reflecting the full effect of the price and cost movements.

The extent of import penetration has been a recurring theme in discussions of the British economy over the past twenty years (see Chapter II and related tables). Table IV.21 shows that over the last ten years the growth rate of total imports and total exports have been broadly similar but within manufacturing exports have grown at only half the rate of imports. Prior to 1978 this increase in the share of the domestic market for manufactures going to foreign competitors cannot be fully explained by price movements and econometric research has typically found an income elasticity of demand for imports in excess of unity.

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(21) Trade figures for the period since September 1981 (following a six month period for which no data is available because of an industrial dispute) show a strong increase in import volume compared to the level in early 1981.

Two broad schools of thought have developed to explain this phenomenon of increased import penetration and they give rise to distinctly different policy prescriptions. The first is represented by the Cambridge Economic Policy Group (Godley, 1979 and Cambridge Economic Policy Review, April 1980) who see, on the continuation of current free trade policies, no end to the displacement of domestic manufactured goods by imports and consider that the resulting balance of payments difficulties will enforce further deflation on the economy.

On the other hand the London Business School (Beenstock and Warburton, 1980) argue that the liberalisation of world trade in the 60's and 70's allied to the UK's accession to the Community in 1973 has led to a once and for all shift in the openness of the UK economy which has allowed greater international specialisation to occur. When the full effects of this changed international environment have worked through they suggest that the growth of import penetration will revert to the trend levels evident in the 50's and early 60's.

It is not clear which of these schools of thought is supported by the interpretation given by Manison (Manison, 1978) to a NEDO study (NEDO, 1977) which showed that unit values of UK exports within most product groups tend to be lower than those in countries such as the Federal Republic of Germany and France while the reverse is true for imports. Manison argues that this is evidence that the UK is slipping downstream in the product cycle and is producing cheaper, less sophisticated goods which are more susceptible to low-cost competition. This appears to be consistent with the finding of the Maldague Report (EEC, 1979).

Studies of the sophistication of UK exports have typically concentrated on the manufacturing sector and overlook the compe-

titive strength of UK service industries. These industries have produced substantial surpluses on the invisible trade account despite the growing debt repayments on foreign held assets associated with the exploitation of North Sea oil.

Structural economic problems

Structural trends

Growth in the economy is not a homogeneous process. An economy with a heavy concentration of slow growing industries can expect to suffer a relatively low aggregate rate of growth in the short to medium term. In addition, the achievable rate of growth will depend on the adaptability of the economy to change, which is in part dependent on the rate at which resources can be switched from sectors which are in relative decline to those in ascendancy.

Table IV.22 compares the productive structure, in terms of value added, of the UK, the Federal Republic of Germany and Community economies and the changes that have occurred between 1973 and 1979. The figures for the shares of value added between sectors show that the UK has a relatively large service sector accounting for nearly 60 % of total value added compared with Germany (52 %) and the Community as a whole (54 %), while the manufacturing sector is appreciably smaller, in particular in those branches producing capital goods.

The comparison of short run sectoral performance between economies is complicated by cyclical influences; nevertheless the relatively poor UK economic performance is reflected in much lower growth rates than in the Community in all sectors except fuels and power and services. At a Community level these were the only sectors to exhibit above average growth rates while within manufacturing only chemical products, office machines, and electrical goods experienced growth rates above that for the economy as a whole. Within UK manufacturing, value added in the chemical products, office machines and rubber and plastic products branches grew more quickly than the average.

Compared with growth rates by sector in the Community as a whole, only in the fuel and power and market service sectors, and in the office machinery branch were growth rates of value

added greater in the UK over the period. In the fuel and power sector this can largely be explained by the build-up in the exploitation of North Sea oil.

Given this background it is instructive to compare the UK and Community sectoral experience more systematically. Despite the rather aggregative nature of the available data the "shift-share" technique, which has been widely used in analysing regional economic performance, appears to be an appropriate analytical tool for such a comparison. The application of this technique involves calculating the difference between the actual change of value added in the regional economy (UK) and the change that would have occurred in each industry if it had experienced the same growth rate as the overall economy (EC-6). This difference, which is designated "net relative change", is then disaggregated into that part which is due to the difference between the sectors' growth rate (EC-6) and the overall economy (EC-6), and that part which is due to a below or above average (EC-6) performance of the industry in the region (UK). These two aggregates are known as the "structural" and "differential" components respectively. A large negative (positive) structural component is taken to indicate a weak (strong) economic base while a large differential component indicates that particular factors are at work in the regional economy.

The results of this exercise are summarised in Table IV.23. It appears that although the structure of UK manufacturing industry did have a negative influence on the relative growth performance between 1973 and 1979, this seems to have been more or less offset by the positive influence of the large service sector (22). The differential compenent is negative in all

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(22) Because no breakdown of the service sector into branches is available, it cannot be discounted that structural influences within the service sector were negative.

cases except fuel and power products and office machines. The conclusion can therefore be drawn that the factors leading to the UK's poor performance tend to be peculiar to the UK and not the result of a heavy dependence of the UK economy on industries which are declining throughout Europe. This conclusion should be considered as tentative as it remains to be tested with a more disaggregated breakdown of economic sectors; moreover the analysis cannot take account of differences in the type and quality of output of sectors across economies.

Table IV.24 gives a sectoral breakdown of investment rates, employment change and productivity growth between 1973 and 1978. The investment figures, as was discussed in the section on investment, at a more aggregated level, show that fixed capital formation as a share of value added in manufacturing tends to be close to both the German and Community figures. Notable exceptions are in the areas of transport equipment, office machinery and rubber and plastic products, the last two of which were identified as having above average growth rates in the UK. Despite experiencing lower overall growth between 1973 and 1978 than in Germany, employment in the UK fell slightly les quickly. For example in branches facing severe economic difficulties such as metal minerals (steel) and textiles the UK has experienced poorer output growth but is shedding labour, if anything, at a slower rate which results in a relative decline of productivity levels (23). This poor performance is found throughout industry with the exception again, of fuel and power and office machines.

Table IV.25, taken from a recent OECD study on positive adjustment policies, presents more detailed and up-to-date natio-

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(23) This slower rate of labour shedding in the period up to 1978 may have been due in part to the existence of the Temporary Employment Subsidy, while the severity of the present recession in the UK may have led to some catch up with other Community countries.

nal data for manufacturing which confirm the trends evident in the data discussed above. Industries which have experienced the biggest falls in output between the two periods 1971-75 and 1976-80 are coal and petroleum products, iron and steel, shipbuilding and marine engineering, motor vehicles, textiles and bricks, whereas the strongest rises have been in chemicals, instrument engineering, and pottery and glass. Between the two periods most industries have experienced growth in output per head, the main exceptions being coal and petroleum products, iron and steel, shipbuilding, and motor vehicles, industries which all experienced large falls in the level of output. Increase in the degree of import penetration have been most marked in instrument and electrical engineering, areas where large increases in output per head were achieved, and in motor vehicles, textiles and footwear. The biggest improvements in export performance were made by chemicals, electrical engineering, shipbuilding and clothing.

Assessment

The foregoing description shows that most sectors in the UK have been affected by the overall slower growth of the economy compared with other Community countries. The shift share analysis suggests that this slower growth is not primarily due to the level of concentration of declining industries in the UK economy, although this is clearly a problem in some regions, but is due to more pervasive factors in the economy as a whole.

The factors contributing to this lower growth have made the process of adapting the economic structure more difficult and more painful. It is striking that, despite significant labour shedding, problem sectors such as metal minerals, transport equipment and textiles have not achieved the same output per head growth as in the rest of the Community. Only the effects of North Sea oil and the relatively small office machinery industry have given above average performance.

The effect of the second oil shock has imparted a renewed urgency into the process of adapting productive structures both in the UK and in the Community generally. Favourable changes in the economic structure of the UK economy require a reversal of the factors which have led to lower than average growth rates in industries that are dynamic in other economies. These factors include issues which have been touched on elsewhere in this paper such as the instability of the economic environment, the loss of international competitiveness and the decline in profitability. Sectoral policy has a major role to play in encouraging R and D and technical innovation and in ensuring that an adequate supply of skilled manpower is available. Attitudes to technical change and mobility, which are difficult to compare across economies, are also important in this respect.

The UK as an oil producer

Oil reserves and production

Since 1975 crude oil production in the UK has been increasing. By 1980 output was equivalent to self sufficiency. Table IV.26(i), which sets out details of production and consumption of primary energy in 1980, suggests that the UK is today self-sufficient in primary energy supplies even after allowing for the depressing effects on consumption of the current economic recession.

Estimates of the amount of oil available for recovery from the North Sea and from other UK offshore areas have been adjusted downwards in recent years. Tables IV.26(ii) and (iii) show these estimates as well as forecast production levels up to 1984 inclusive. It is evident that potentially recoverable reserves should be sufficient to maintain the current rate of production for between 25 and 50 years. Thus, while allowance must be made for increasing marginal costs of production and other technical factors, foreseen or unforeseeable, inherent in the harsh offshore operating environment, it is difficult to accept prima facie, the view that oil production must necessarily peak in the mid 1980's, as has often been suggested.

Depletion policy

Current depletion policy is aimed at preventing substantial surplus production capacity developing in the 1980's. The authorities believe that to ensure security of supply up to the end of the century, it is in the national interest to flatten out the level of oil production from the North Sea. This implies that account is taken of likely output levels from fields already in production, in decisions to develop more recently discovered fields; e.g. development of the Clyde Field has been delayed by two years. The current economic downturn and the slow rates of growth foreseen also mean that

the amount of oil which the UK needs to be self-sufficient is not likely to grow much over the next few years.

It has been suggested that this approach :

(i) fails to maximise the present value of the discounted flow of revenue which could be obtained from the profits of immediate high production levels and the resulting tax revenues;

(ii) disrupts the cash-flow assumptions made by the oil companies when deciding to explore for and exploit particular oil fields and acts as a disincentive to future oil exploration and development by these companies.

The weight to be given to these arguments depends upon assumptions about the future price of oil. It is notable that exploration and appraisal activity in the North Sea picked up during 1980 (24) reflecting the effects of the second oil price shock in 1979.

Further support to current depletion policy is given by official estimates of the UK energy balance up to the year 2000 released in the latter part of 1979 (Financial Times, October 1979); these figures suggested that on the basis of current policies, by the end of the century there will be a shortfall in domestic primary energy production of between 50 and 100 million tonnes of coal equivalent.

Since the UK authorities have not insulated domestic energy prices from world prices it is unlikely that this cautious approach to the exploitation of recoverable oil resources will have

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(24) Drilling starts in 1980 were 25 % above those in 1979 and applications for the latest (seventh round) of licensing reached record levels.

been a disincentive to develop other energy sources, or to continue with vigorous energy conservation measures. Indeed a recent study (Morel, NIESR, August 1980) finds a clear relationship between the relative real price of various sources of energy and the share of these fuels consumed.

Community aspects

Table IV.27 shows recent developments in the Community oil market. Oil imports have been reduced considerably, reflecting energy saving, a depressed economy and the rapid increase in crude oil production within the EC. The latter is substantially due to UK production which in 1981 is expected to be around 20 % of gross inland EC consumption of crude oil and oil equivalents.

About half UK crude oil production in 1980 was exported and nearly 60 % of these exports went to other EC Member States, mainly the Federal Republic of Germany (see Table IV.28). This emerging interdependance within the EC is significant for the increased security of supply it provides and it reinforces Community arrangements which require member countries to hold minimum levels of oil stocks.

Impact on UK economy

The main macro-economic effects of North Sea oil are summarised below :

- The additional value added created by North Sea oil production, in which the profit element is substantial gives rise to increased tax revenues (see Table IV.29). The remainder, mostly net profits, accrues largely to non-resident oil companies. Despite the high levels of taxation it is clear that returns from the North Sea oil investment are presently much higher (25) than would have been obtained from investment in the domestic economy.

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(25) The safeguard provisions of the Petroleum Revenue Tax (PRT) allow for a remission of tax if the rate of return should fall below 30 %.

- By producing all its own oil the UK avoids the need to exchange non-oil exports for oil imports. Indeed as the real price of oil rises, other industrial countries without oil require greater amounts of non-oil exports to provide a given level of oil imports; with North Sea oil the UK can postpone these pressures. France and the Federal Republic of Germany had total oil bills in 1980 equivalent to 4 % and 3 % of GDP respectively while the UK has a positive balance of trade in oil (see Table IV.30).
- Partly as a result of increased North Sea oil production the international value of sterling has appreciated. It is very difficult to put a numerical value on this effect although most commentators think rather less than half the appreciation of the real exchange rate since 1978 can be attributed to oil.

In evaluating the overall impact of these factors it is necessary to consider the dynamic aspect of the economy. Thus developments will be influenced by existing trends, Government policies, and measures taken to absorb and utilise the revenues accruing from oil production.

It has been argued that the UK's move towards self-sufficiency in oil supplies is bound to be accompanied by structural changes elsewhere in the economy, in particular by a contraction of manufacturing output, provoked by an appreciation of the sterling exchange rate (Forsyth and Kay, Fiscal Studies, 1980). However, others have suggested that such an adjustment is by no means inevitable (Worswick, NIESR, November 1980) and have pointed out that there are other ways in which the economy could develop, given appropriate fiscal and monetary policies. Nonetheless, some of the recent fall in manufacturing output (see Table II.4) is clearly attributable to the effects of North Sea oil acting through the higher exchange rate for sterling,

although the long-run decline in the share of manufacturing in GDP is a phenomenon seen in many, though not all, advanced industrialised countries in the last 25 years and was clearly evident in the UK throughout the 1970's.

The UK's move towards oil self-sufficiency has postponed the need for the type of structural changes required in non-oil producing countries where additional exports must be generated to meet the increased oil bill. The finite character of the offshore reserves nevertheless suggests that steps should be taken to transform its windfall nature into a permanent increment to national income. One way in which this could be done, is for the UK to enjoy a higher rate of economic growth now that the previous constraint of the adverse pre-oil balance of payments position is gone. For example the Cambridge Economic Policy Group (Cambridge Economic Policy Review, April 1981) has argued that a strong pound is not necessary for fighting inflation and that the effects of North Sea oil have been wasted by the failure to expand domestic demand. It is important however, that the pattern of demand should be appropriate since it is clear that, in so far as increased oil output has led to an appreciation of sterling, this in turn has permitted a rise in private consumption at a time when output and investment were declining (see Chapter II, especially Table II.4). However, a strong pound encourages enterprises to be more efficient and has also made the liberalisation of exchange controls easier permitting a considerable growth in net investment abroad (see Table II.14); in this way the UK has been able to exchange present oil output for external assets which will provide income streams to contribute to the balance of payments in future years.

Table IV.1 : Fixed investment in GDP, 1958-1980

% of GDP and ratios

	UK	D	EC-9	UK/EC-9
1958-67	17,3	24,8	21,5	0,80
1968-72	18,6	24,8	22,5	0,83
1973	19,7	24,5	22,8	0,86
1974	20,5	21,9	22,4	0,92
1975	19,7	20,7	21,3	0,92
1976	19,2	20,7	21,1	0,91
1977	18,3	20,8	20,7	0,88
1978	18,1	21,5	20,7	0,87
1979	17,7	22,7	21,0	0,84
(1980)	17,5	23,7	21,3	0,82
1973-80	18,8	22,1	21,4	0,88

Sources : Eurostat and Commission staff.

Table IV.2 : Share of investment in GDP by sector, 1960-1978

as % of GDP

Years	UK				D (c)				EC-6 (d)			
	60-68	69-73	74-78	1978	60-68	69-73	74-78	1978	60-68	69-73	74-78	1978
1. Energy + mining	2,7	1,8	2,7	2,7	1,7	1,6	1,7	1,5	2,0	1,6	1,8	1,7
2. Manufacturing	3,7	3,5	3,4	3,5	5,3	5,9	4,1	4,1	4,5	4,7	3,8	3,6
3. Industry (1 + 2)	6,4	5,3	6,1	6,2	7,0	7,5	5,8	5,7	6,5	6,3	5,6	5,3
4. Building + construction	0,3	0,3	0,3	0,3	0,6	0,6	0,3	0,4	0,5	0,5	0,4	0,4
5. Agriculture	0,6	0,6	0,6	0,6	1,3	0,8	0,8	0,9	1,2	0,9	0,9	1,0
6. Services (b)	8,4	9,6	9,4	9,1	11,9	13,4	11,9	12,5	10,7	11,9	11,8	11,6
7. Total business (b) (3+4+5+6)	15,7	15,9	16,5	16,2	20,8	22,3	18,8	19,4	18,9	19,7	18,5	18,2
8. General government	2,2	2,9	2,4	1,9	4,4	4,4	3,7	3,6	3,1	3,4	3,1	2,9
9. Total (7 + 8)	17,9	18,8	18,9	18,1	25,2	26,6	22,5	23,0	22,1	23,1	21,5	21,1
10. Equipment	:	8,9 (a)	9,1	9,2	:	10,0 (a)	8,8	9,2	:	9,0 (a)	8,4	8,4
11. Construction	:	8,9 (a)	8,7	7,7	:	16,5 (a)	13,3	13,3	:	13,4 (a)	12,3	11,8
of which												
12. Housing	:	3,5 (a)	3.6	3.2	:	7,1 (a)	5,6	5,6	:	6,0 (a)	5,6	5,4
13. Services (6-12) (e)	:	(6,1)	5,8	5,9	:	(6,3)	6,3	6,9	:	(5,9)	6,0	6,2
14. Business (7-12) (e)	:	12,4	12,9	13,0	:	(15,2)	13,2	13,8	:	(13,7)	12,9	12,8

(a) 1970-1973.
(b) Including housing.
(c) Including VAT-deductible expenditures.
(d) EC excludes DK, GR, IRL, L.
(e) Excluding housing.

Sources : Eurostat and Commission staff.

Table IV.3 : Real rates of return on trading assets, 1962-1980

	Industrial & Commercial Companies		Manufacturing companies
	Pre-tax real rate of return[a] %	Post-tax real rate of return[b] %	Pre-tax rate of return %
1962-1967	10,9	6,8	10,1
1968-1973	9,3	6,3	8,3
1973	9,0	8,1	8,1
1974	6,0	6,0	4,3
1975	5,2	3,9	3,9
1976	5,6	5,4	4,1
1977	6,7	6,8	5,8
1978	6,7	6,3	6,0
1979	5,0	6,1	3,6
1980	3,0	3,2	2,0
1973-1980	5,9	5,7	4,7

(a) Net operating surplus on UK corporate activities, i.e. gross operating surplus less capital consumption at current replacement cost, excluding North Sea oil activities.

(b) Bank of England estimate

Sources : British Business, 18-24 September 1981; Bank of England Quarterly Bulletin.

Table IV.4 : International comparisons of profitability : Net pre-tax rate of return (a), 1963-1979

%

	Industry plus transport (b)			Non-financial corporations (c)				Manufacturing industry			
	Canada	D	UK	USA	Japan	F	UK	Canada	USA	D	UK
Averages for years											
1963-67	12	18	10	22	:	12	10	18	36	21	14
1968-71	10	17	9	17	:	15	8	16	26	22	11
1972-75	11	14	7	15	18	13	6	17	21	16	8
1976-79	10	14(d)	6	15	15	9	5	14	22	17(d)	6
Years											
1976	9	13	5	14	14	8	5	13	22	16	5
1977	9	13	7	15	14	9	6	12	24	17	7
1978	9	15	6	15	16	9	6	13	23	18	7
1979	11	:	6	14(e)	14	10	5	17	20	:	4

(a) Defined as net operating surplus as percentage of net capital stock of fixed assets (excluding land).

(b) Manufacturing, mining, construction, public utilities and transport and communications industries.

(c) Non-financial corporate and quasi-corporate enterprises (including public corporations).

(d) 1976-78.

(e) Rough estimates by Department of Industry.

Source : British Business, 4-10 September 1981.

Table IV.5 : Gross fixed capital formation, retirements and gross capital stock at 1975 prices and replacement cost

UKL '000 million

	Gross domestic fixed capital formation £ million at 1975 prices	Retirements at 1975 prices	Gross capital stock at 1975 replacement cost	% change in gross capital stock
1973	21 195	5 022	444 300	3,6
1974	20 567	5 195	459 100	3,3
1975	20 416	5 580	473 400	3,1
1976	20 649	5 964	487 400	3,0
1977	20 161	5 777	501 000	2,8
1978	20 836	6 453	514 600	2,7
1979	20 898	6 773	528 100	2,6
1980	20 761	6 520	541 600	2,6

Sources : HMSO, Economic Trends and Commission staff.

Table IV. 6 : Public expenditure on research and development, 1973-1978

	UK	D	EC-9
Public R & D expenditure as a % of GDP			
1973	1,25	1,23	1,05
1974	1,32	1,21	1,03
1975	1,29	1,24	1,04
1976	1,36	1,17	1,02
1977	1,21	1,07	0,95
1978	1,05	1,12	0,95
Composition in 1978 (% of total)			
Exploration and exploitation of the earth	1,0	2,0	2,0
Planning of the human environment	2,3	3,1	3,4
Health	2,7	5,5	5,4
Energy	8,1	13,6	11,6
Agriculture	3,9	2,1	3,7
Industry	4,8	7,6	8,2
Social problems	1,1	4,6	3,2
Space	2,5	4,2	4,4
Defence	52,1	12,2	22,3
General promotion of knowledge	20,5	45,1	35,5
	100	100	100
Total expenditure in MEUA	2 540	5 436	14 706

Source : Eurostat

Table IV.7 : R & D carried out by industry in the main industrial countries, 1977 (a)

	Percentages, by industrial sector				
	USA	D	Japan	F	UK (d)
1. Electrical machinery	7,8	:	10,9	3,9	4,3
2. Electronic equipment	12,1	:	12,9	18,9	22,6
3. Total electrical and electronics (1+2)	19,9	:	23,8 (e)	22,8	26,9
4. Chemical, petroleum etc.	14,0	27,4	19,6	18,3	18,3
5. Aircraft	23,7	7,3	17,0	18,6	18,3
6. Transport (including motor vehicles and ships)	11,4	12,4		11,9	6,4
7. Metals, instruments and machinery (b)	21,0	17,3	19,0	13,8	18,1
8. All other (c)	10,0	8,9	20,6	14,6	12,0
9. Total intramural industrial R & D expenditure	100	100	100	100	100

(a) Total intramural industrial expenditure on research and development, 1977.

(b) Includes office equipment and electronic computers.

(c) Includes other manufacturing, mining and quarrying and services R & D expenditure.

(d) Figures are for 1978.

(e) For Japan, total electrical and electronics includes computers.

Sources : UK Business Monitor (MO 14).

Table IV.8 : Comparative labour productivity growth rates, 1963-1977

% change per annum

	Total Economy		Manufacturing	
	1963-73	1974-78	1963-73	1973-77
B	4,3	2,9	n.a.	n.a.
D	4,3	3,2	5,6	4,5
F	4,4	2,7	5,4	3,2
I	5,3	1,0	5,7	1,4
UK (a)	3,3	0,9	4,3	1,1
EC-5 (e)	4,4	2,4	5,3(c)	3,1 (d)
Japan	8,7	3,3(b)	9,4	4,9
USA	1,9	0,2(b)	2,8	1,2

(a) Exluding North Sea oil.

(b) 1974-79

(c) 1961-73

(d) 1974-78

(e) Weighted average of B, D, F, I, UK

Source : European Economy, No. 9, July 1981.

Table IV.9 : Comparative capital productivity growth rates, 1961-1978

	% change per annum	
	1961-73	1974-78
B	0	-1,0
D	-2,0	-2,7
F	1,0	-1,7
I	0,2	-1,7
UK (a)	-0,5	-2,4
EC-5 (b)	-0,3	-1,7

(a) Excluding North Sea oil

(b) Weighted average of B, D, F, I, UK

Source : European Economy, No. 9, July 1981.

Table IV.10(i) : Changes in population of working age, 1977-86 GB(d) Thousand

	1977-81	1981-86
Total population of working age (a)	+732	+762
of which		
men	+378	+437
non-married women	+552	+250
married women	-198	+75
aged 16-44	+1 092	+1 083
aged 45-59/64	-360	-321
of which		
men 45-64	-169	-104
women 45-59	-191	-217

(a) Men aged 16-64 and women aged 16-59

Table IV.10(ii) : Components of change in the labour force, 1977-86 GB(d) Thousand

	1977-81			1981-86		
	Population effect (b)	Activity rate effect (c)	Total	Population effect (b)	Activity rate effect (c)	Total
Total labour force	+624	-764	-140	+717	-32	+685
of which						
men	+329	-471	-146	+418	-96	+322
non-married women	+411	-110	+301	+212	-42	+170
married women	-116	-179	-195	+87	+106	+193

(b) The change in labour force that would have occured if the activity rate in each age group had remained over the period at its value in the initial year.

(c) The residual change:total change less the change due to the population effect.

Table IV.10(iii) : Total labour force (excl. students), 1975-86 GB (d) Thousand

	Male	Married female	Non-married female	All
1975	15.796	6.602	3 179	25 577
1976	15 882	6 742	3 327	25 951
1977	15 856	6 922	3 349	26 127
1978	15 807	6 834	3 436	26 077
1979	15 773	6 754	3 500	26 027
1980	15 716	6 697	3 576	25 989
1981	15 710	6 627	3 650	25 987
1982	15 748	6 578	3 711	26 037
1983	15 840	6 649	3 769	26 258
1984	15 925	6 733	3 801	26 459
1985	15 986	6 788	3 828	26 602
1986	16 032	6 820	3 820	26 672

(d) GB = UK less Northern Ireland

Source : HMSO, Employment Gazette, April 1981.

Table IV.11 : Activity rates 1971-86 - GB

Per cent

Including students	1971	1977	Forecast 1981	Forecast 1986
Male				
16-19	98,8	99,0	99,0	99,0
20-24	98,8	98,9	98,9	98,9
25-34	97,5	97,6	96,7	97,0
35-44	98,3	98,1	97,3	97,4
45-54	97,6	97,2	95,6	95,2
55-59	95,3	93,5	90,2	88,7
60-64	86,6	81,5	69,9	63,3
65-69	30,6	22,0	13,0	12,5
70+	11,0	7,5	4,9	4,3
All ages	85,8	83,4	80,9	80,4
Married female				
16-19	42,4	54,7	50,7	50,9
20-24	46,7	59,0	57,8	57,7
25-34	38,4	52,2	50,2	48,6
35-44	54,5	67,4	66,6	69,3
45-54	57,0	65,1	66,7	70,6
55-59	45,5	54,9	51,8	52,9
60-64	25,2	24,6	19,6	16,8
65+	6,5	5,0	3,4	2,8
All ages	42,3	50,4	48,8	49,9
Non-married female				
16-19	97,7	98,0	98,0	98,0
20-24	94,4	92,9	92,9	92,9
25-34	80,8	79,8	78,4	78,1
35-44	80,0	77,5	77,7	77,1
45-54	78,1	77,0	76,3	75,9
55-59	67,2	64,8	63,2	62,6
60-64	33,7	25,8	18,5	16,4
65+	6,3	4,1	2,2	1,6
All ages	45,6	50,4	51,0	51,1
All female				
16-19	91,7	94,6	94,3	94,0
20-24	66,0	74,4	76,0	75,6
25-34	44,0	56,5	55,6	55,4
35-44	57,4	68,7	68,2	70,5
45-54	60,6	67,1	68,4	71,6
55-59	51,1	57,3	54,6	53,3
60-64	28,2	25,0	19,2	16,7
65+	6,4	4,4	2,6	2,0
All ages	45,5	50,4	49,7	50,3

Source : HMSO, Employment Gazette, April 1981.

Table IV.12 : Activity rates by age-groups (a) : Federal Republic of Germany, UK and EC, 1973-1979

%

Age-groups	F.R. of Germany		United Kingdom		EC-9	
	Male	Female	Male	Female	Male	Female
1975						
14-19	37,0	32,9	33,1	29,1	28,8	24,7
20-24	76,7	68,0	89,6	65,8	78,4	61,4
25-29	89,0	55,5	96,7	50,0	93,0	50,9
30-39	97,5	47,4	97,9	56,8	97,3	45,4
40-49	97,4	47,8	97,6	67,0	96,2	46,3
50-54	94,0	46,1	96,3	64,7	92,5	43,9
55-59	87,0	37,8	93,9	53,4	85,4	36,2
60-64	62,4	15,8	84,3	30,4	62,1	19,2
65-69	17,2	6,6	31,4	11,1	21,9	7,5
70+	6,3	2,0	8,8	2,4	6,6	2,0
1977						
14-19	32,3	28,5	33,1	29,4	26,9	23,2
20-24	76,7	67,8	89,2	67,5	78,2	63,1
25-29	87,6	58,4	96,3	52,7	92,3	54,8
30-39	97,3	49,1	97,5	56,3	96,9	47,8
40-49	97,5	48,4	97,1	67,5	95,7	47,7
50-54	93,8	45,4	95,5	63,9	91,8	43,9
55-59	86,0	38,9	91,9	56,9	84,2	38,0
60-64	53,2	13,8	80,1	26,7	56,8	17,8
65-69	13,8	4,7	27,2	10,9	19,2	6,9
70+	5,4	1,8	8,1	2,1	6,1	1,9
1979						
14-19	31,2	27,0	33,2	29,6	26,2	21,0
20-24	78,5	69,4	89,1	68,3	77,8	63,8
25-29	87,1	60,1	96,8	44,3	91,7	57,0
30-39	97,2	51,4	96,6	55,1	96,6	50,6
40-49	97,3	49,3	96,4	66,7	95,6	48,8
50-54	93,7	43,1	94,0	63,3	91,4	43,9
55-59	83,9	37,6	90,7	53,0	81,4	36,7
60-64	50,3	14,8	74,3	23,9	54,6	16,8
65-69	11,7	4,5	19,2	6,6	15,5	5,4
70+	3,9	1,6	5,1	1,5	4,5	1,6

(a) Labour force as a percentage of the total population of the same age and sex.

Source : Eurostat.

Table IV.13 : Estimates of overmanning in UK industry (a)

Thousands

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

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

(b) Construction, gas, electricity and water, transport and communication.

(c) Excludes private professional and scientific services.

Source : Cambridge Economic Policy Review; April 1981, Vol. 7, No. 1

Table IV.14 : Industrial distribution of jobs or adults supported under various employment measures (d), 1975-1979

GB Thousands

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

(a) Including 5.1 in agriculture and mining and quarrying.

(b) Including 0.2 in agriculture.

(c) excluding the Job Release Scheme.

(d) Only the "Temporary Short-time Working Compensation" and "Job Release Scheme" are now in effect, and both continue to accept new claims.

Source : HMSO, Employment Gazette, No. 79; Cambridge Economic Review, April 1981; Volume 7, No. 1

Table IV.15 : Sectoral employment - average annual growth rates, 1960-1978

UK %

	1968/ 1960	1973/ 1968	1978/ 1973	1975/ 1973	1978/ 1975
Agriculture	-3,8	-3,5	-1,7	-3,4	-0,5
Energy products	-3,2	-5,1	-0,4	0,1	-0,8
Industrial products	-0,5	-1,0	-1,4	-2,3	-0,8
Intermediate product	-0,6	-1,2	-1,5	-1,8	-1,3
Equipment products	-0,1	-1,0	-1,0	-1,6	-0,6
Current consumption products	0,9	-1,0	-2,1	-3,7	-1,1
Food products	-0,3	-0,5	-0,9	-2,2	-0,1
Construction and civil engineering	1,2	0,2	-1,9	-3,4	-0,9
Market services	1,1	1,0	0,6	0,7	0,5
Non-market services	1,5	1,5	1,6	3,5	0,4
Total	0,3	0,1	-0,1	-0,1	-3

Source : European Economy, No. 9, July 1981.

Table IV.16(i) : UK unemployment rates, 1975-1980

as % of full employees

Year	Male		Female	
	All unemployed	Excl.School-leavers	All unemployed	Excl. School-leavers
1975	5,5	5,3	2,1	1,9
1976	7,1	6,8	3,5	3,1
1977	7,4	7,0	4,3	3,8
1978	7,2	6,9	4,4	3,9
1979	6,7	6,4	4,3	3,9
1980	8,7	8,1	5,7	5,0

Source : HMSO, Employment Gazette, September 1981.

Table IV.16(ii) : EC unemployment rates, 1970-1982

	1970	1979	1980	1981	1982
B	2,2	8,7	9,3	11,6	12,3
DK	1,0	5,3	6,2	8,2	8,7
D	0,6	3,4	3,4	4,8	5,6
GR	:	(2,2)	(2,8)	(2,3)	(3,6)
F	1,3	6,0	6,5	7,8	8,1
IRL	5,3	7,4	8,3	10,4	10,9
I	4,4	7,5	8,0	8,6	9,0
L	0,0	0,7	0,7	1,0	1,2
NL	1,0	4,1	4,9	7,3	9,2
UK	2,5	5,3	6,9	10,2	11,3
EC	2,0	5,5	6,1	7,7	8,5

Source : European Economy, No. 10, December 1981.

Table IV.17 : Unemployment by age and sex and for specific groups in the population at July, 1966, 1973, 1980

GB (% of the relevant population)

	1966	1973	1980
Males:			
by age:			
school leavers	1	1	32
others under 20	1	4	12
aged 20-24	1	3	9
25-54	1	2	5
55-59	1	3	5
60-64	4	7	11
minority groups: (a)	:	2	7
Females:			
by age:			
school leavers	1	1	30
others under 20	1	2	11
aged 20-24	1	1	6
25-34	0	0	3
35-54	0	0	2
55-59	0	1	2
married:	0	0	2
minority groups: (a)	:	1	4

(a) New Commonwealth and Pakistan : to May 1980 only.

Source : Cambridge Economic Policy Review, April 1981, Volume 7, No. 1

Table IV.18(i) : Unemployment by industrial sectors, excluding school leavers, 1977-1981

GB — May figures

SIC 1968	Agriculture, forestry and fishing I	Mining and quarrying II	Manufacturing III-XIX	Construction XX	Gas, electricity and water XXI	Transport and communication XXII	Distributive trades XXIII	Financial, professional and miscellaneous services XXIV-XXVI	Public administration and defence XXVII	Others not classified by industry	Unemployed excluding school leavers
	Number										Thousand
1977	23,7	16,6	330,6	204,1	9,2	59,7	131,7	211,6	68,7	187,8	1 243,7
1978	24,1	22,1	333,7	186,5	8,6	58,4	132,7	219,0	76,2	218,9	1 280,2
1979	21,8	23,3	314,0	160,0	7,7	54,3	122,8	209,1	72,3	216,8	1 202,3
1980(a)	22,7	24,8	399,7	189,6	7,6	63,4	146,7	245,0	77,0	219,0	1 395,6
1981	37,8	31,6	754,9	356,9	10,2	105,7	238,0	396,4	105,5	327,2	2 364,3
	Rate										Per cent
1977	5,9	4,5	4,4	14,2	2,7	4,0	4,7	2,9	4,2	-	5,3
1978	6,1	5,9	4,5	13,2	2,5	3,8	4,6	3,0	4,7	-	5,4
1979	5,7	6,4	4,3	11,3	2,2	3,6	4,2	2,8	4,4	-	5,1
1980(a)	5,9	6,8	5,6	13,4	2,2	4,1	5,1	3,2	4,8	-	5,9
1981	9,9	8,6	10,7	25,2	3,0	6,9	8,3	5,2	6,5	-	10,0

(a) From October 1979, the figures are affected by the introduction of fortnightly payment of benefit

Source : HMSO, Employment Gazette, September 1981.

Table IV.18(ii) : Distribution of unemployment by occupational group (male and female), 1979-1981

GB

	Managerial and professional	Clerical and related	Other non-manual occupations	Craft and similar occupations, including foremen, in processing, production, repairing, etc.	General labourers	Other manual occupations	All occupations
	Percentages of total unemployment						
1979 Mar	8,2	14,1	5,9	11,4	36,2	24,2	100,0
June	8,3	14,9	5,9	10,4	37,2	23,2	100,0
Sep	9,4	16,0	6,0	9,5	36,5	22,6	100,0
Dec(a)	8,9	15,1	6,1	10,1	36,1	23,7	100,0
1980 Mar	8,0	14,4	6,3	11,1	35,8	24,4	100,0
June	7,3	14,3	6,2	11,4	36,3	24,5	100,0
Sep	8,7	14,4	6,0	12,0	34,5	24,5	100,0
Dec	8,6	13,1	5,9	13,9	32,7	25,7	100,0
1981 Mar	8,3	12,7	6,1	15,0	31,7	26,1	100,0
June	8,5	12,5	6,0	15,2	31,7	26,1	100,0

(a) From October 1979, the figures are affected by the introduction of fortnightly payment of benefit.

Source : HMSO, Employment Gazette, September 1981.

Table IV.19 : Movements in duration of unemployment in the UK, 1972-1981

Reference Period	Numbers (000's) of men and women unemployed, by duration of unemployment in weeks							
	0 - 2	2 - 4	4 - 8	8 - 13	13 - 26	26 - 52	52 & over	Total unemployed
July 1972	137,2	73,8	92,1	——— 204,3 ———		166,2	157,2	830,8
July 1977	189,5	199,8	230,3	150,6	233,7	242,6	307,1	1 553,5
July 1978	214,9	151,3	214,1	133,8	226,9	243,0	328,4	1 512,5
July 1981	196,3	189,1	354,8	266,4	531,0	687,6	629,9	2 852,1
	Numbers of men and women unemployed by duration in weeks as % of total unemployment							
July 1972	16,5	9,0	11,0	——— 24,6 ———		20,0	18,9	100
July 1977	12,2	12,9	14,8	9,7	15,0	15,6	19,8	100
July 1978	14,2	10,0	14,2	8,8	15,0	16,1	21,7	100
July 1981	6,9	6,6	12,4	9,3	18,6	24,1	22,0	100

Source : HMSO, Employment Gazette and Commission staff.

Table IV.20 : Indices of effective exchange rate and unit labour costs, 1971-1981

1970 = 100

	Effective exchange rate	% change on previous year	Relative unit labour costs (a) in national currency	% change on previous year	Relative unit labour costs in common currency	% change on previous year
1971	99,5	-0,5	102,4	2,4	101,9	1,9
1972	95,7	-3,8	104,0	1,5	99,5	-2,4
1973	85,5	-10,6	104,3	0,3	89,2	-10,3
1974	82,5	-3,5	110,8	6,3	91,5	2,5
1975	76,2	-7,6	128,7	16,2	98,2	7,3
1976	65,0	-14,8	137,3	6,6	89,2	-9,1
1977	61,9	-4,8	142,8	4,0	88,4	-0,9
1978	62,6	1,1	151,3	6,0	94,6	7,1
1979	66,6	6,4	166,0	9,7	110,5	16,7
1980	73,0	9,6	188,3	13,5	137,4	24,4
1981 (b)	72,8	-0,2	191,6	1,8	139,5	1,5
% change 1970-77		-38,1		+42,8		-11,6
% change 1977-81		+17,6		+34,2		+57,8

(a) Unit labour costs in national currency by reference to the weighted average for main competing countries.

(b) Forecast based on information available at mid-September.

Source : Eurostat and Commission staff.

Table IV.21 : Volume of UK manufactured exports and imports, 1970-1980

Change over preceding year (%)

	Exports	Imports
1970	0	8,3
1971	10,4	9,2
1972	1,2	18,3
1973	15,1	20,2
1974	4,0	5,9
1975	-2,9	-6,5
1976	9,0	9,0
1977	8,3	11,0
1978	0,8	12,4
1979	0	14,7
1980	0,9	-1,3
1970-1980	4,5	9,1
Growth rate of total exports and imports, 1970-1980	6,5	4,7

Source : British Business

Table IV.22 : Comparative structures of total output and sectoral growth rates, 1973-1979

	Share in value added (%)						Average annual rate of growth of value added at constant prices (1973-1979)		
	UK		D		EC-6(a)		UK	D	EC-6(a)
	1973	1979	1973	1979	1973	1979			
Agriculture	2,0	1,9	2,9	2,5	4,2	3,9	0,6	0,2	1,3
Fuels, power products	4,5	7,3	5,8	5,5	5,2	5,6	10,2	4,5	3,9
Manufactured products	27,5	24,9	34,9	33,4	30,4	29,4	-0,3	1,8	1,9
Intermediate products	5,7	5,0	7,1	7,3	6,4	6,4	-0,6	3,1	2,3
Metal minerals	2,1	1,6	1,8	1,8	1,9	1,7	-2,8	2,9	0,7
Non-metallic minerals	1,4	1,2	2,1	1,9	1,8	1,7	-1,6	1,7	1,3
Chemical products	2,2	2,3	3,3	3,6	2,7	3,0	1,9	4,1	3,9
Equipment products	10,6	9,5	15,2	14,9	12,0	11,7	-0,4	2,1	2,1
Metal products	1,8	1,5	3,9	3,4	3,0	2,7	-1,2	0,7	0,6
Industrial machines	2,8	2,4	4,1	3,7	3,0	2,7	-1,2	0,9	0,7
Office machines	0,5	0,9	1,1	1,4	0,7	0,9	11,7	5,5	7,2
Electrical goods	2,2	2,0	3,5	3,8	2,6	2,8	0	3,7	3,4
Transport equipment	3,3	2,6	2,7	2,7	2,7	2,7	-2,5	2,4	2,2
Food, beverages, tobacco	4,1	4,0	4,6	4,1	4,3	4,2	1,0	0,7	2,4
Current consumption goods	7,2	6,4	8,1	7,0	7,8	7,1	-0,7	0,3	0,9
Textiles, clothing, leathers	2,7	2,3	2,3	2,0	2,9	2,5	-1,3	-0,3	0,2
Paper	2,3	2,1	2,3	2,1	2,1	1,9	-0,1	1,2	1,2
Rubber, plastic products	0,9	0,9	1,5	1,5	1,2	1,1	1,7	2,3	2,2
Other	1,4	1,1	1,9	1,5	1,7	1,5	-2,1	-1,7	0,8
Building, construction	8,2	6,7	6,9	6,3	7,6	6,6	-2,0	1,2	0,2
Market services	43,9	44,2	36,8	39,8	39,7	41,6	3,8	3,8	3,3
Non-market services	13,9	15,0	12,4	12,5	12,8	12,9	2,5	2,6	2,6
TOTAL	100	100	100	100	100	100	1,4	2,5	2,5

(a) Excluding DK, IRL, L.

Source : Eurostat and Commission staff.

Table IV.23 : Shift-share analysis of gross value added, 1973-1979

	(1)	(2)=(4)+(6)	(3)=(5)+(7)	(4)	(5)	(6)	(7)
	Actual change in value added(a) 1973-1979 UKL mill.	Net relative change[b] 1973-1979		Structural component[c]		Differential component[c]	
		UKL mill.	%	UKL mill.	% change	UKL mill.	% change
Agriculture	99	-234	-11,0	-170	-8,0	-64	-3,0
Fuels, power products	3 638	+2 894	+60,8	+430	+9,0	+2 464	+51,8
Manufactured products	-505	-5 041	-17,4	-1 196	-4,1	-3 845	-13,3
Intermediate products	-207	-1 141	-19,1	-109	-1,8	-1 032	-17,3
Metal minerals	-359	-698	-32,3	-268	-12,4	-430	-29,9
Non-metallic minerals	-139	-375	-24,9	-121	-8,1	-254	-16,8
Chemical products	291	-68	-3,0	+223	+9,7	-291	-12,7
Equipment products	-250	-1 996	-17,9	-305	-2,7	-1 691	-15,2
Metal products	-121	-415	-22,1	-238	-12,7	-177	-9,4
Industrial machines	-178	-631	-21,7	-336	-11,4	-295	-10,3
Office machines	509	+422	+75,6	+196	+35,1	+226	+40,5
Electrical goods	13	-351	-15,1	+167	+7,2	-518	-22,3
Transport equipment	-471	-1 019	-29,3	-68	-2,0	-943	-27,3
Food, beverages, tobacco	264	-405	-21,8	-46	-1,1	-359	-20,7
Current consumption goods	-313	-1 500	-19,8	-815	-10,7	-685	-9,1
Textiles, clothing, leathers	-210	-658	-23,0	-435	-15,2	-223	-6,8
Paper	-26	-398	-16,7	-209	-8,8	-189	-7,9
Rubber, plastic products	99	-43	-4,7	-24	-2,6	-19	-2,1
Other	-177	-402	-27,9	-161	-11,1	-241	-16,8
Building, construction	-949	-2 301	-26,6	-1 322	-15,3	-979	-11,3
Market services	4 235	-3 014	-6,5	+2 604	+5,6	-5 618	-12,1
Non-market services	2 439	+143	+1,0	+162	+1,1	-19	-0,1
TOTAL	8 956	-7 545	-7,2	+384	+0,4	-8 029	-7,6

(a) At 1975 prices and exchange rates.

(b) The "net relative change" is calculated by applying the overall Community growth rate to the 1983 figures for value added in each sector and then subtracting the result from the actual 1979 figure.

(c) See definitions on page 72 of text.

Source : Eurostat and Commission staff.

Table IV.24 : Sectoral breakdown of investment rates, employment changes and productivity growth, 1973-1980

	Gross Fixed Capital Formation as % of value added 1973-78			Employment Average annual rate of change (%) 1973-78			Labour Productivity Average annual rate of change (%) 1973-78		
	UK	D	EC-6	UK	D	EC-6	UK	D	EC-6
Agriculture	29,3	28,1	23,5	-1,8	-3,7	-2,8	3,5	4,8	3,6
Fuels, power products	55,7	30,9	35,6	-0,5	-1,4	-0,6	9,3	1,9	3,7
Manufactured products	12,3	11,6	13,0	-1,6	-2,4	-1,5	1,4	3,5	3,0
Intermediate products	22,3	16,9	21,4	-1,4	-2,1	-1,1	0,7	4,5	3,0
Metal minerals	29,6	21,2	26,0	-2,1	-3,1	-1,5	-1,6	4,9	1,4
Non-metallic minerals	11,3	13,2	15,9	-2,8	-3,4	-2,1	1,1	4,1	2,8
Chemical products	22,7	16,8	21,7	0,4	-0,3	0,1	1,9	4,0	3,7
Equipment products	9,5	10,2	11,1	-1,2	-1,8	-1,1	1,1	3,4	3,0
Metal products	8,8	8,6	9,0	-1,5	-2,7	-1,8	0,8	2,2	1,9
Industrial machines	9,9	8,5	9,5	-0,4	-1,7	-1,0	0	1,7	1,5
Office machines	6,5	13,8	16,6	-1,7	-0,6	-0,7	11,8	5,7	7,3
Electrical goods	9,4	9,4	10,0	-1,6	-2,4	-1,1	2,2	6,9	5,0
Transport equipment	10,4	14,8	14,7	-1,3	-0,3	-0,4	0,8	1,7	2,4
Food, beverages, tobacco	11,4	10,9	11,4	-1,4	-1,4	-1,0	2,6	1,4	2,9
Current consumption goods	9,1	9,7	9,8	-2,4	-3,9	-2,3	1,7	3,2	2,7
Textiles, clothing, leathers	8,3	7,8	7,8	-3,4	-5,8	-3,4	2,4	5,3	3,0
Paper	9,4	9,7	11,1	-1,3	-2,3	-1,5	0,8	2,0	2,3
Rubber, plastic products	4,5	11,1	10,8	-1,4	-1,1	-0,7	3,5	1,9	2,1
Other	13,5	11,1	11,3	-2,1	-4,0	-1,7	-0,5	1,5	2,1
Building, construction	4,8	4,9	5,5	-2,0	-3,3	-1,8	0,4	3,1	1,5
Market services	21,7	30,0	28,7	0,7	-0,2	1,2	0,7	3,7	1,9
Non-market services	17,7	28,5	23,9	1,5	1,9	1,8	1,8	0,6	1,0
TOTAL	19,2	21,9	21,9	-0,9	-1,1	-0,1	1,5	3,1	4,4

Source : Eurostat and Commission staff.

Table IV.25 : Changes in output, employment, productivity and trade performance by manufacturing industries, 1971-1980

Sector (Weight per 1,000)		1975=100			Per cent	
		Output	Employment	Output per head	Imports / Home demand plus exports	Exports / Home demand plus exports
ALL MANUFACTURING	1971-75	103	104	98	17	17
(1 000)	1976-80	102	95	107	20	20
Food, drink and tobacco	1971-75	100	103	97	18	4
(110)	1976-80	105	96	110	16	5
Coal & petroleum products	1971-75	112	104	108	14	11
(13)	1976-80	102	98	104	13	13
Chemicals	1971-75	100	100	100	17	25
(82)	1976-80	115	101	114	20	30
Iron & steel	1971-75	117	103	114	11	13
(50)	1976-80	96	88	109	16	16
Non-ferrous metals	1971-75	108	109	100	30	15
(17)	1976-80	105	99	106	32	19
Mechanical engineering	1971-75	96	103	94	17	32
(132)	1976-80	92	95	97	20	35
Instrument engineering	1971-75	93	193	90	29	35
(17)	1976-80	104	96	109	35	37
Electrical engineering	1971-75	96	104	93	19	22
(95)	1976-80	107	96	113	25	29
Shipbuilding and marine engineering	1971-75	98	101	98	47	16
(20)	1976-80	84	95	88	29	25
Motor vehicles	1971-75	114	108	105	13	28
(62)	1976-80	99	99	101	26	29
Aerospace	1971-75	100	100	100	18	32
(24)	1976-80	94	94	101	21	32
Other vehicles	1971-75	102	99	103	14	60
(11)	1976-80	102	103	99	22	53
Metal goods nes	1971-75	104	104	101	8	12
(66)	1976-80	97	97	101	11	15
Textiles	1971-75	108	111	98	17	19
(57)	1976-80	96	91	105	24	23
Leather goods	1971-75	105	104	101	20	20
(4)	1976-80	92	92	100	28	20
Clothing	1971-75	98	108	92	15	8
(26)	1976-80	101	94	108	22	14

(Continued)

Sector (Weight per 1,000)		1975=100			Per cent	
		Output	Employ-ment	Output per head	Imports / Home demand plus exports	Exports / Home demand plus exports
Footwear	1971-75	104	112	93	19	9
(9)	1976-80	99	93	107	28	11
Bricks & cement	1971-75	109	114	96	3	6
(24)	1976-80	93	92	101	4	8
Pottery & glass	1971-75	98	102	96	12	22
(16)	1976-80	107	96	112	14	22
Timber & furniture	1971-75	104	103	100	26	3
(36)	1976-80	99	97	102	26	5
Paper & board	1971-75	121	105	116	48	6
(9)	1976-80	112	93	120	50	8
Other paper products, printing & publishing	1971-75	109	103	103	4	7
(75)	1976-80	107	96	112	5	9
Rubber	1971-75	104	103	100	9	20
(19)	1976-80	112	88	128	13	23
Other manufactures	1971-75	102	104	98	12	13
(26)	1976-80	115	102	113	15	14

(a) The weights are proportional to the distribution of net output in 1975.

Source : OECD, Special Group of the Economic Policy Committee on Positive Adjustment Policies, CPE/PAP(81) 11, November 1981.

Table IV.26(i) : United Kingdom crude oil production in the context of production and consumption of primary energy : 1980

	million tonnes oil equivalent	% of total primary energy consumption
Production		
Oil	80	42
Coal	77	40
Natural gas	32	16
Nuclear/hydro	9	5
	198	103
Consumption		
Oil	71	37
Coal	71	37
Natural gas	41	21
Nuclear/hydro	9	5
	192	100

Table IV.26(ii) : Oil reserves, 1975-1981

millions of tonnes

	1975/78	1978/81	April 1981
Official estimate of range of recoverable oil reserves	3 000 to 4 500	2 200 to 4 400	2 175 to 4 350

Table IV.26(iii) : Oil production, 1975-1981

millions of tonnes

	1975/80	1980	1981	1982	1983	1984
Official forecasts of range of future production levels	263	80,5	80-95	85-110	85-115	90-120

Sources : HMSO, Energy Trends, October 1981, and the Department of Energy's report on the development of the UK Continental Shelf (known as the Brown Book).

Table IV. 27 : Development of the oil market EC-9, 1973-1981

Million tonnes of oil equivalent

	1973	1975	1976	1977	1978	1979	1980	1981 (a)
1. Net oil imports (crude and refined)	585,8	482,6	517,8	481,1	472,1	472,2	420,3	389,0
2. Crude oil production	12,0	12,1	22,2	48,6	63,7	89,0	90,7	95,0
3. Gross inland consumption of crude oil and oil equivalents(b)	555,7	478,0	508,4	496,2	512,7	525,2	479,6	459,0
4. Gross inland consumption of primary energy(b)	919,1	847,4	902,0	897,9	924,5	969,3	925,9	917,0
5. Oil as a proportion of total inland energy consumption (%)	60,5	56,4	56,4	55,3	55,5	54,2	51,8	50,0
6. Dependence on oil imports(c) (%)	61,7	55,0	55,5	51,9	49,5	47,6	44,3	41,3

(a) Estimates.
(b) Equal to production + net imports - increase in stocks - ships'bunkers (energy balances).
(c) Net oil imports from non-member states as % of gross inland consumption of primary energy + bunkers.

Source : Eurostat and Commission Staff

Table IV. 28 : Exports of North Sea oil, 1977-1981

million tonnes

	1977	1978	1979	1980	1981 (Jan/April)
Total Exports	15,6	23,9	38,9	38,8	-
Exports to EC	8,0	11,8	22,4	25,1	-
Exports to the F.R. of Germany	3,0	6,4	12,0	14,8	4,8

Source : HMSO, Brown Book

Table IV.29 : Government oil revenue, 1976-1985

UKL'000 million

	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
Value of North Sea oil produced	0,7	2,2	2,8	5,3	8,7	12,0	16,4	20,3	26,6	29,7
Government revenues from North Sea oil :										
Royalties	0,1	0,2	0,3	0,7	1,1	1,4	1,9	2,4	3,1	3,4
Petroleum Revenue tax	0,0	0,0	0,1	0,7	1,7	2,5	3,0	4,7	6,7	8,5
Corporation tax	0,0	0,0	0,0	0,1	0,5	0,7	1,1	1,6	2,5	2,5
Supplementary tax	0,0	0,0	0,0	0,0	0,0	2,0	2,6	3,3	4,3	4,9
Total revenue :										
A. at current prices	0,1	0,2	0,4	1,5	3,3	6,6	8,6	12,0	16,6	19,3
B. at 1980 prices	0,2	0,3	0,5	1,7	3,3	6,0	7,0	8,9	11,2	11,9

Production, price and exchange-rate data and projections (a)

North Sea oil production										
Total : million tones	12	37	53	76	80	88	109	119	136	133
Average price per tonne UKL	56	60	54	70	111	136	150	171	196	224
Exchange rate $/UKL	1,79	1,76	1,92	2,12	2,32	2,04	2,00	1,89	1,78	1,69

(a) These figures are broadly in line with the assumptions made in this paper about future movements in (i) the price of crude oil (ii) in UK production levels, insofar as the years up to 1983 are concerned. The production figures for 1984/85 assume the effects of a strong recovery in the UK economy. Overall, however, the figures give a good appreciation of the broad magnitude of total Government revenue from domestic oil production.

Source : Phillips and Drew, Forecast for the UK, Nov. 1981.

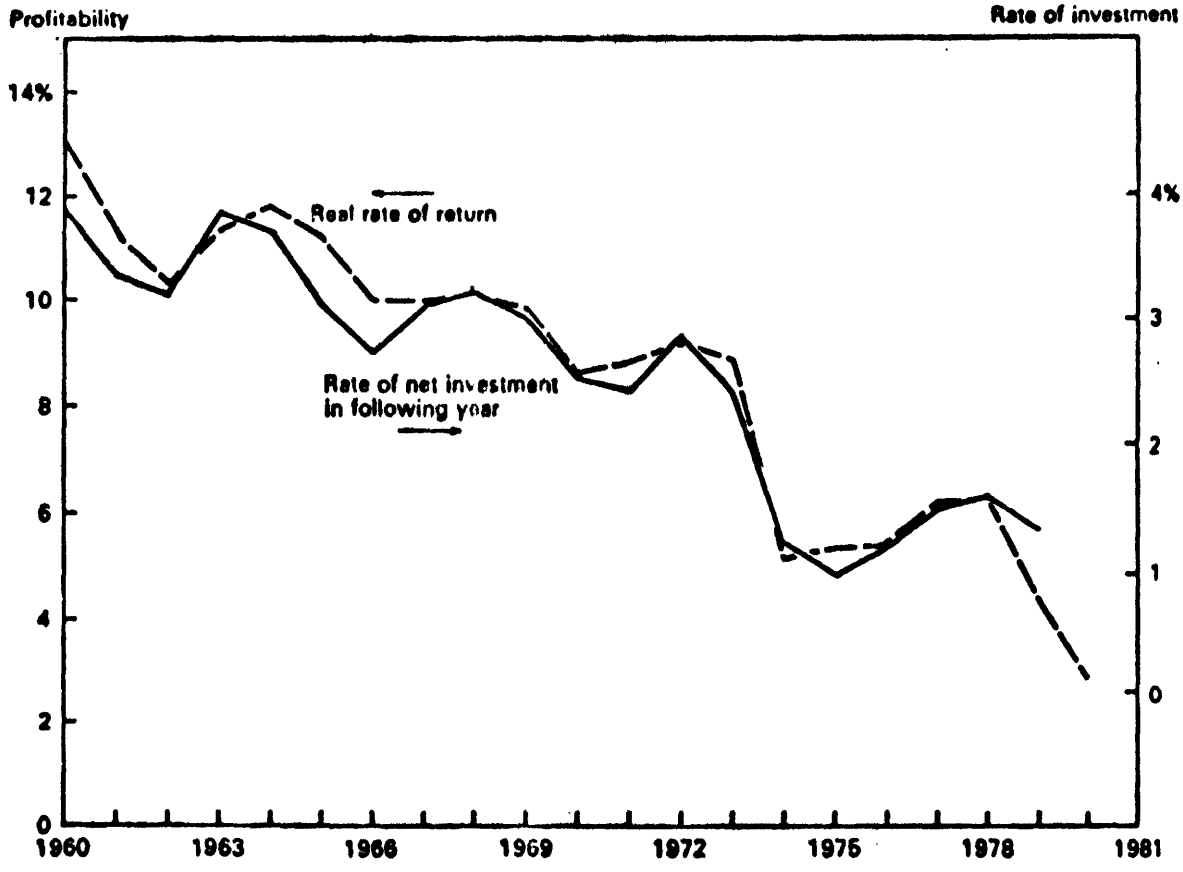
Table IV. 30 : Impact of oil on UK balance of payments (a), 1976-1985

	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
Visible items										
North Sea oil production Total : million tonnes	12	37	53	76	79	88	109	119	136	133
Average price per tonne UKL	56	60	54	70	111	136	150	171	196	224
Value of North Sea oil produced UKL billion	0,7	2,2	2,8	5,3	8,7	12,0	16,4	20,3	26,6	29,7
Imported capital equipment Total : UKL billion	-0,9	-1,1	-1,0	-1,0	-1,0	-1,0	-1,1	-1,0	-0,8	-0,6
Total visibles : UKL billion	-0,2	1,1	1,8	4,3	7,7	11,0	15,3	19,3	25,8	29,1
Invisible items										
Interest due abroad & repatriation of overseas earnings : UKL billion	-0,2	-0,4	-0,6	-1,3	-1,6	-1,8	-2,2	-2,6	-3,3	-3,5
Balance of payments impact										
Total impact of North Sea oil production on current account :										
A. at current prices UKL billion	-0,4	0,7	1,2	3,0	6,1	9,2	13,1	16,7	22,5	25,6
B. at 1980 prices UKL billion	-0,7	1,0	1,6	3,5	6,1	8,3	10,7	12,4	15,2	15,8
Balance of trade in oil										
Crude oil exports : UKL billion	0,3	1,0	1,3	2,7	4,3	6,7	9,2	12,1	17,2	19,0
Crude oil imports : UKL billion	4,1	3,7	3,3	3,4	4,1	4,0	3,8	4,4	5,2	6,1
Net trade in oil products : UKL bn	-0,1	0,0	0,0	-0,1	0,1	0,0	0,0	0,0	0,0	0,0
Oil balance : (visible UKL billion)	-3,9	-2,7	-2,0	-0,8	0,3	2,7	5,4	7,7	12,0	12,9

(a) The same observations as in Table IV.29 apply here. However, the implied figures for net crude oil exports differ slightly from those given in Table II.13, which are based upon an earlier Commission analysis.

Source : Phillips and Drew, Forecast for the UK, Nov. 1981.

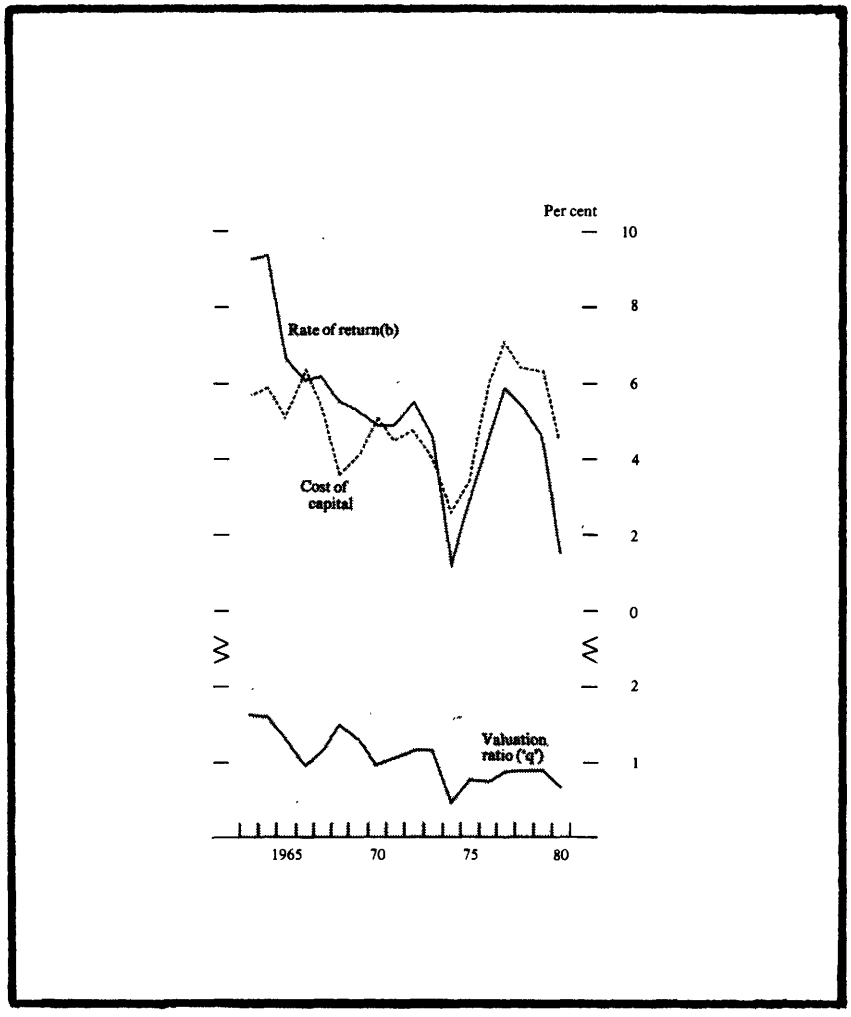
Graph IV.1 : Profitability and investment (a), 1960-1980



(a) Industrial and commercial companies excluding North Sea oil activity.

Source : Confederation of British Industry, The will to win, 1981.

Graph IV.2 : Rate of return, cost of capital and valuation ratio ('q') (a), 1963-1980

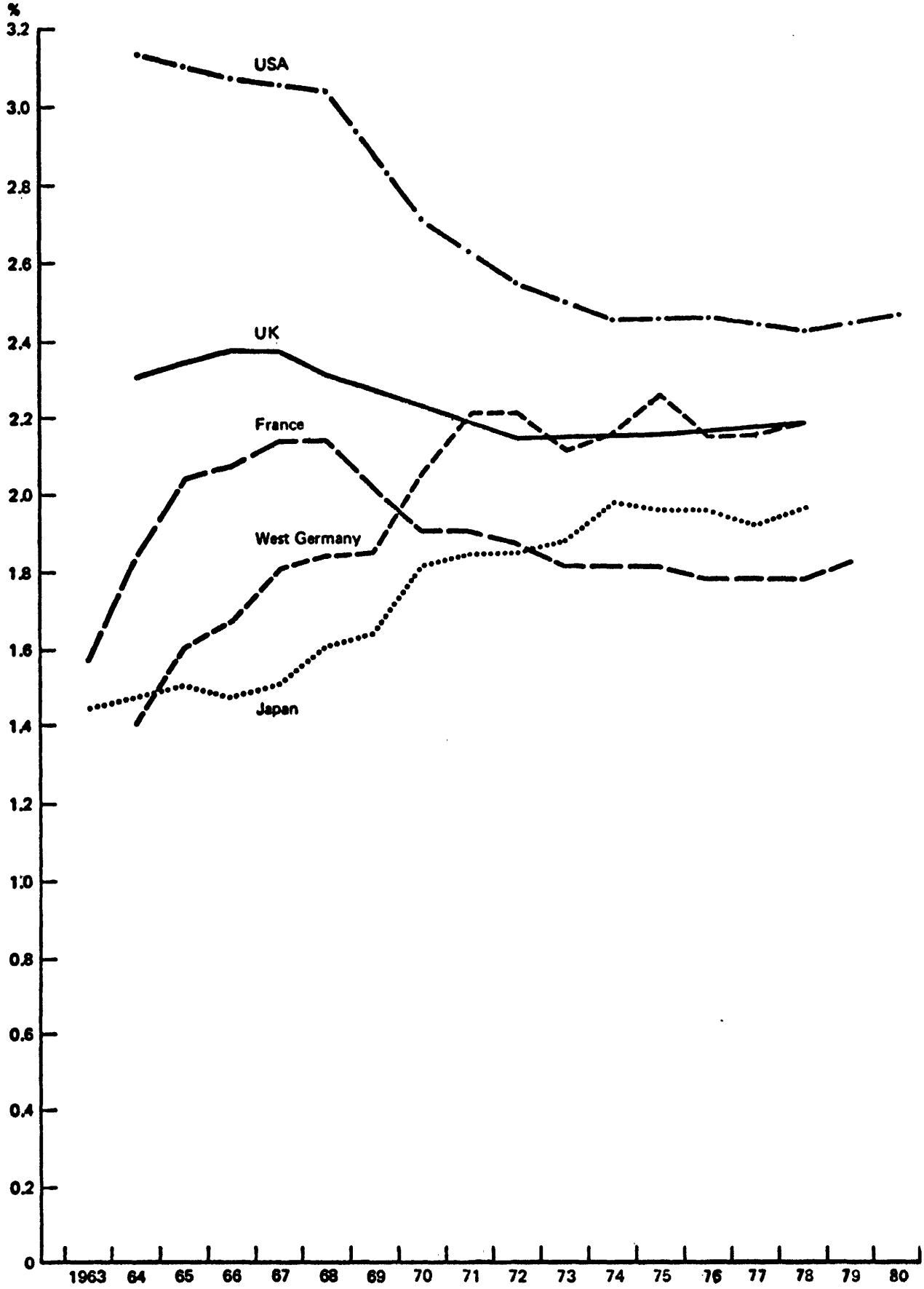


(a) The rate of return covers non-North Sea industrial and commercial companies, but the cost of capital and the valuation ratio ('q') are for all industrial and commercial companies.

(b) Forward-looking post-tax real rate of return on trading assets.

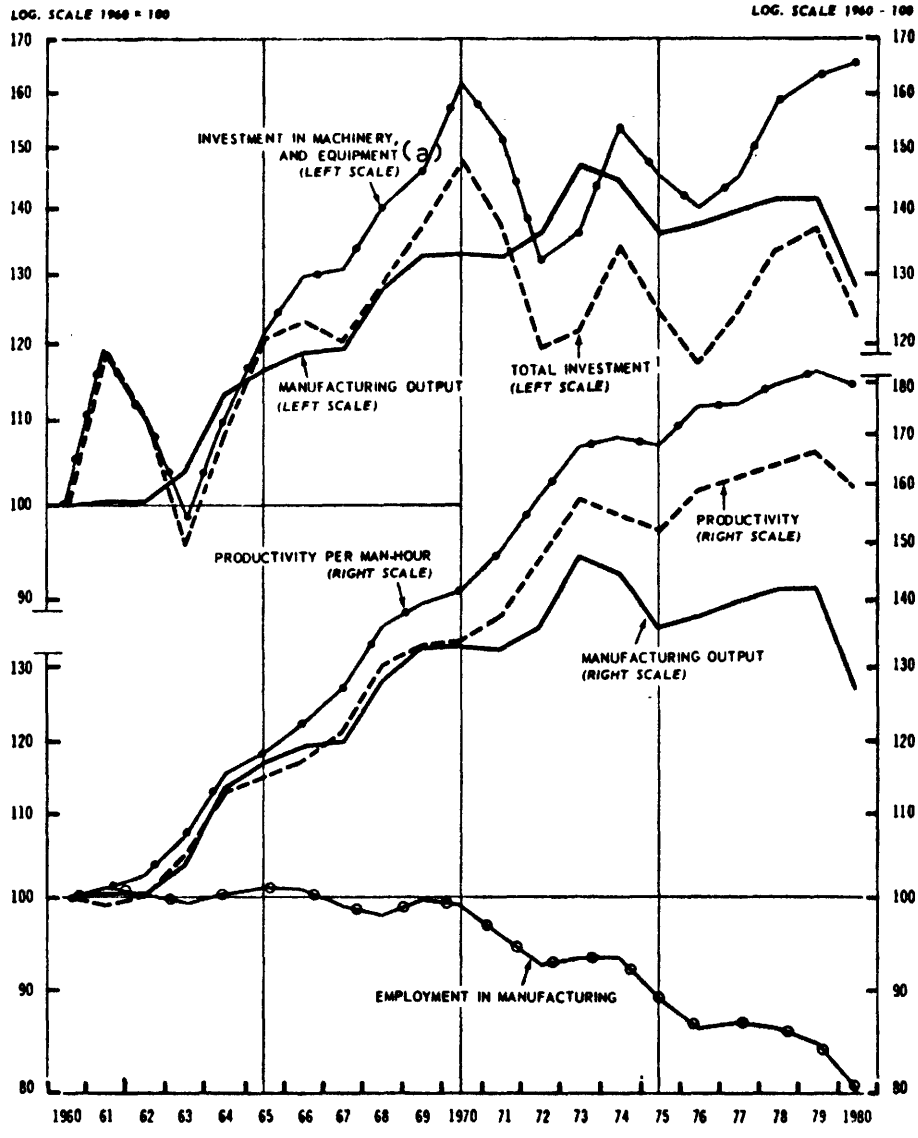
Source : Bank of England Quarterly Bulletin, June 1981.

Graph IV.3 : Total R & D expenditure as a proportion of GDP, 1963-1980



Source : National Economic Development Council, R & D and innovation : current sectoral work 1981, Memorandum by the Director General.

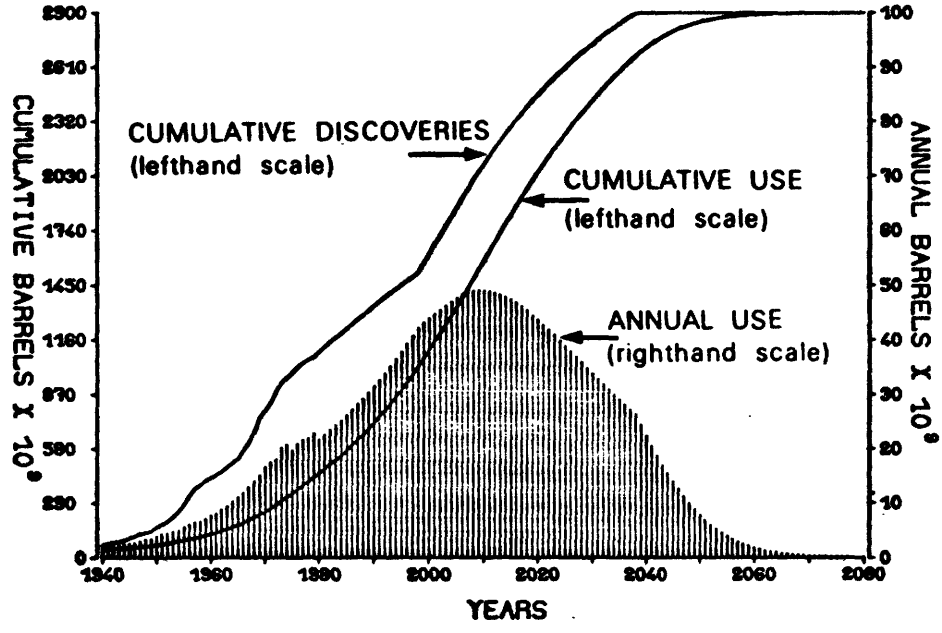
Graph IV.4 : Output, productivity and investment in manufacturing, 1960-1980



(a) Excluding leasing.

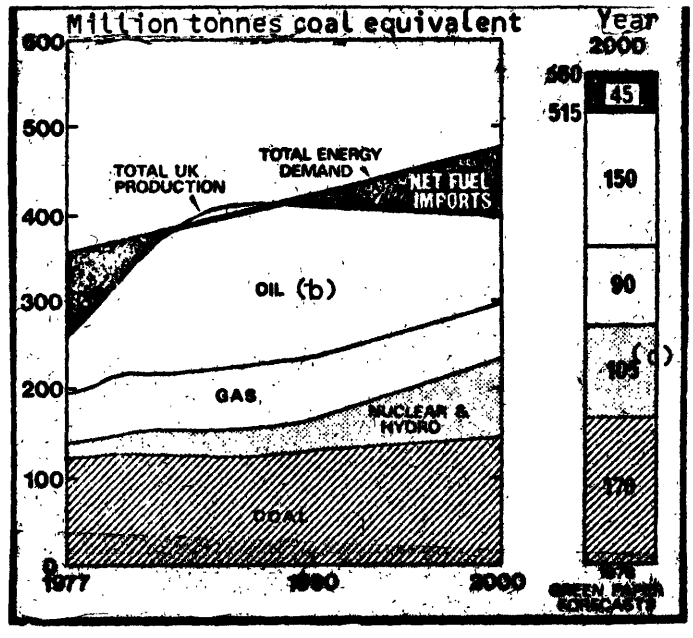
Source : OECD, Economic Outlook, July 1981.

Graph IV.5 : World oil discoveries, 1940-2080 (a)



(a) The 90 % probable Future of Oil. Ultimate recoverable oil is 2900 x 10^9 barrels and the growth rate in oil use is 3,75 % p.a.

Graph IV. 6 : UK primary energy balance, 1977-2000



(b) Incl. non-energy (i.e. chemical feedstock) and bunkers

(c) Incl. renewables

Source : Department of Energy Statistics.

V. SUMMARY AND CONCLUSIONS

This section summarises the main findings of the analysis and demonstrates, in general terms, the constraints on policy, but does not make specific policy recommendations since this would not be appropriate for a document of this nature.

Economic trends

The paper (Chapter II) has examined the economic trends over a period of years and has tried to identify the reasons for the United Kingdom's relatively weak performance compared to that of its European partners.

In particular the rate of economic growth in the UK has usually been below, and price inflation usually above the Community average (Tables II.1, II.2 and II.3). Moreover the rate of price inflation has exhibited much more variability around its trend than has been evident elsewhere (Table II.4).

The discovery and exploitation of North Sea oil has had a significant impact on the economy, in particular as the build-up of production coincided with a dramatic rise in oil prices. Not only do tax revenues arising from North Sea activities now provide some 6 % of all tax receipts, but the UK's self-sufficiency in oil releases it from the need to export manufactured goods to pay for oil imports. In comparison, France and the Federal Republic of Germany had total oil bills in 1980 equivalent to 4 % and 3 % of GDP respectively (Table II.13).

The benefit of oil to the balance of payments, in conjunction with firm monetary and fiscal policies, which have been established since 1979 within the framework of the Medium Term Financial Strategy (MTFS), helped to move the current account into substantial surplus : indeed the official forecast is for a surplus of UKL 6 billion in 1981. This favourable position contrasts sharply with that in most other European economies.

In addition it can be argued that the MTFS, which seeks to lower the rate of inflation by progressively reducing the rate of monetary expansion, particularly by restraining the level of public sector borrowing, has helped to reduce the inflation rate (12,0 % in 1981) towards the OECD average level with further falls into single figures in prospect.

The reduction in the public sector borrowing requirement to 4,4 % of GDP in 1981 from some 5,5 % in 1979 (26) again distinguishes the UK from other European economies where, partly as a result of the recession, public borrowing as a percentage of GDP has been increasing.

These successes have, however, been bought at the cost of a sharp fall in output from mid-1979 to mid-1981 as is shown by Graph II.2. At the same time there has been a steep drop in investment, a movement which has shown a remarkable correlation with the downward trend in profits (Graph IV.1). According to conventional investment measures, profitability is now at a historically low level, and has undoubtedly been strongly affected by the recent loss of export price competitiveness, of over 50 % (see Table IV.21), which resulted both from the rapid wage inflation in 1979 and 1980 and the appreciation of sterling. Both these aspects of the UK's performance now need to be countered through improvements in efficiency and restraint in wage costs; there is some evidence to suggest that this is already occurring.

Forecasts for the medium-term (see Chapter III) made by independent bodies, and based on the assumption that the Government will continue with monetary and fiscal policies in line with the MTFS, show a wide range of possible outturns.

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(26) Financial years.

Nevertheless there is a measure of consensus that there will be a relatively slow recovery in output, coupled with further modest reductions in the rate of inflation. The more optimistic forecasts see unemployment stabilising at around its current level while others expect further increases (see Table III.4).

Main economic issues

An examination of investment (p.47) tends to contradict the widely held view that the deficiencies in the UK's economic performance stem from too little investment. Although it is true that total investment absorbs a smaller proportion of GDP than in the Community as a whole, industrial investment seems to be at a very similar level. What the evidence does suggest is a poorer return on this investment than elsewhere, both in output terms and in terms of profitability. However, following the oil shocks there is a clear need for additional investment effort to adjust the structure of the economy to meet the requirements set by the change in relative prices and by new patterns of demand. The fact that investment has fallen in the UK since the second oil shock suggests that this positive adjustment of the economy is not occurring as quickly as it should.

An analysis of sectoral and structural trends (pps.71-75) leads to the view that low growth is not due to a predominance of the industries which are slow growing in an European context, but to an inadequate performance throughout British industry. This conclusion combined with the evidence of poor output returns to investment suggests there may be a misdirection of investment, and/or unfavourable institutional and sociological factors such as the attitudes, abilities and practices of management and unions.

In the UK over 10 % of the workforce is now unemployed compared with under 8 % in the Community as a whole (see pps.62-63).

In part this rapid increase in UK unemployment has been caused by the shake-out of labour from industry over the course of the recession, and there is much anecdotal evidence that overmanning has been substantially reduced, resulting in significant productivity gains. Nevertheless, the rise in measured unemployment has been moderated by a decline in activity rates. Should this decline reverse with an upturn in economic activity, which is clearly possible, then the impact of future growth on unemployment will be that much reduced.

Conclusion

In many ways the conditions for a better relative economic performance by the UK have been improved in recent years. In contrast to most other industrial nations, the outlook for the current account of the balance of payments and public sector borrowing should increase the room for manoeuvre in setting economic policy, and should not threaten the recovery in output foreseen. In addition, the underlying rate of inflation has been much reduced and there is evidence that improved attitudes and behaviour by both sides of industry are leading to increased efficiency. The most important problems now are how to restore British industry's internal and external competitiveness and the profitability of investment, both of which are required to ensure an improved investment performance, facilitating the restructuring of the economy so allowing a sustained upward movement in economic activity. As such changes will take some time, measures to alleviate the unemployment problem in the shorter term, especially among young people are required. Moreover there is evidence that the framework of industries' training in the UK is less well adapted to the needs of a modern economy than in other Community countries, and in in particular in the Federal Republic of Germany. The authorities, aware of these problems, have recently announced a set of measures which amount to a considirable extension of the entire training system.

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