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International Competitiveness and Productivity - Measuring Quality Increases.

STATISTICS

January 1983

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INTERNATIONAL COMPARISONS

LINE TO TAKE

In the period 1975-81, increases in earnings in the UK far-outstripped those in major competitors except France. When oil production is excluded, UK productivity rose far less than that of all major competitors. The exchange rate declined only a little. As a result our competitiveness (RNULC) worsened by almost 40 per cent.

Germany and, even more so, Japan did so well on productivity that they out-performed us on competitiveness despite a substantially higher exchange rate.

Percentage Increases 1975 - 1981

	Industrial Production		Earnings in Manufacturing	Production +		1981 Effective Exchange Rate 1975=100	1981 Relative Normalised Unit Labour Costs (RNULC) 1975=100
	incl. oil and gas	excl.oil and gas		Incl. oil. and gas	Excl. Oil and gas		
US	28.1		65.0*	15.5*		93.9	97.3
Japan	46.1		57.1 ≠	54.1 ≠		126.5	87.4
Germany	15.1		42.0 ≠	21.0 ≠		128.8	107.9
France	15.1*		111.0 ≠	24.0 ≠		94.4	101.0
UK	-0.3	-9.7	117.9	22.6 ≠	11.1 ≠	96.1	137.0

\+ Productivity defined as Industrial Production/Employment in manufacturing

* 11 months estimate

≠ 10 months estimate

Source: Production, Earnings, Productivity,
OECD (except UK industrial production - CSO)

Exchange Rate; RNULC
IMF

Feb 83 competitiveness & prod

x Def

Stats

Transterra Business Brief
Donald Last

TRANSTERRA LTD 156 HIGH STREET SEVENOAKS KENT
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Dear Sir,

25th February 1983 No 559 (year 11)

There are limits to the fall in oil prices. According to US experts crude is unlikely to fall under $26 a barrel (currently $34). Reason: this is the b r e a k - e v e n point for oil production in Mexico, in the North Sea and in Alaska. Neither of the two super producers, Russia and the US, are interested in oil prices slipping under that mark: the Russians want to earn foreign currency with their oil and many (independent) US oil producers would no longer be able to make a profit with prices under $25-$26. Note also that product prices of heating oils and gasoline in America have been under pressure and refiners need crude to be $25 a barrel to be in the black. So this seems to be the balance point. Other considerations:

* Crude oil prices need to be $24 a barrel for the price of oil in r e a l terms to return to 1975-77 levels - the last period of reasonable activity and employment in Western industry. In a truly excellent article, "Why oil prices must fall more" by Chase Manhattan adviser Geoffrey Maynard (FT Feb 23), the author points out that the cut in real oil prices is u r g e n t if profits in manufacturing industry are to be restored and investment encouraged. He also points out that real wages in industrial countries must also be cut, along with oil prices, if employment is to really recover.

A $7, or 21%, cut in crude prices could raise OECD GNP output by an extra ¾% during 1983/84, and cut inflation by 3 points less than it might otherwise have been end-1984 (see Jan 28 Brief).

A $7 drop in oil prices has an immediate impact on foreign exchange: later it should have a beneficial influence on interest rates by reducing inflation and inflationary expectations.

* The appreciation in the US dollar this week seems misconceived. A drop of $7 would mean the US input bill would drop £11bn but the US trade account would still be substantial. It might also reduce the anticipated US inflation rate from 5% to 4% but a similar benefit will be enjoyed by all other OECD countries. On fundamental grounds the $ is heavily overvalued against the DMark and Japanese Yen, and even the pound, and this week's uptick in the $ probably represents a "fear factor", that too sharp a drop in oil prices would harm the world economy. Therefore:

Expect a $7 cut to eventually lead to a stronger DMark, post-March 6 election. Also speculation in the EMS will now grow steadily (the Belgian franc was forced outside its limits last week). At some point weakening oil prices might rebound on the strong Dutch guilder because its current account surplus is heavily dependent on natural gas exports.

* A $7 cut should not undermine the pound's trade-weighted value. It has fallen to under 80 but there are strong compensatory factors, namely the prospect of Mrs T winning the next election (participants believe this will cause the £ to rebound) and the continuing current account surplus. It is more a question of the DM and Japanese Yen being strong and attracting money out of sterling, rather than the pound being intrinsically weak.

As a Western oil producer, the Canadian $ will suffer more than sterling because, like the US$, it is very uncompetitive against the DM, more uncompetitive than the £.

The Australian $ is now a firm devaluation candidate because the Labor opposition has promised it. Even without the promise the unit would be weak because Labor plans to increase the budget deficit by some 50%, perhaps more; and inflation is running at 11% already, nearly twice the OECD average.

Oil-poor South Africa would gain considerably from a 20% fall in oil prices. And fortuitously it has just discovered oil offshore at Mossel Bay. Lower oil prices would also sharpen the competition from the Pacific Basin economies.

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Investment in 'energy use' as an alternative to investment in 'energy supply'. This paper, published by the Department of Energy, is one of the first anywhere in the world to attempt such an analysis. It concludes: c o n s e r v a t i o n offers significant savings on fuel bills for given standards of domestic comfort or of industrial output. But the potential for saving peak capacity needs is highly unpredictable, and certainly much smaller than is popularly supposed. Investment in new s u p p l y c a p a c i t y itself leads to energy saving, because the new plant replaces plant which is less efficient. For example, if the efficiency of CEGB plant in 81 had still been at 73 levels, 6% more primary fuel would have been needed to produce the same amount of electricity. For details contact DoE, Thames House S, Millbank, London SW1P 4QJ, Tel: 01-211 3000.

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Starved of natural energy sources, J a p a n would benefit most from a 21% cut in oil prices among the industrial nations. It would save over $1bn a month in foreign exchange, equal to t w i c e the current account surplus. The country's estimated GNP growth would be improved by 1.25% over 2 yrs whilst its inflation rate would drop by 2.7% in the first year, accumulating to 5% in the second. Japan has actually had falling retail prices since October so inflation has been squeezed out already.

The boost to d o m e s t i c real incomes will encourage a shift to consumption away from exports. This will be reinforced by the protectionist moves in America and Western Europe, which have so far put 40% of Japanese exports under 'voluntary' restraints. T h u s : Japan in the mid-80s will be a prime export market for those capable of exploiting the situation.

N o w is the time to get into Japanese business. The way is open, because European and American competitors find it just as hard to make the cultural leaps as any UK exporter. A business friend who regularly travels to Japan offers some valuable observations on the Japanese mentality:

As readers of Shogun will know, they are a most disciplined society, still extremely status conscious. Their mentality commits them to work for country, company and self in that order. They out-work us. The official working week might be 40 hours. Most middle sized companies work all day Saturday (alternate in some cases) and late hours in the evening.

Their industrial base is built on very small units. For example, Mitsubishi relies heavily on a cell type structure of small companies. Because of this, their textiles industry, for example, has a well diversfied base which is expanding and evolving all the time. This in turn makes subsequent products based on textiles more interesting.

Consumers have a very commercial mentality and take long-term decisions. On account of their style of living (they generally live in very small houses), clothing & food purchases have a high priority - 30% of their disposable income is spent shopping. As they want to show their neighbours how well they are doing, every product must not only be identified, but must be the best. Hence there is tremendous product development.

D u t c h society is the apotheosis of the collectivist, egalitarian welfare state - and its present disabilities show the terminal state of such systems. Holland is at present in its most severe recession since World War II, with output dropping consistently since 1980 and a further fall likely this year. Unemployment reached a seasonally adjusted 15.9% last month and is rising steadily. The government's budget deficit is likely to equal 13% of national income in 83. According to the OECD the "explosive rise in social spending must be stopped and the economy reconstructed".

* The number of people with a claim to income is rising at a rate of 1.5% a year but employment in the market sector has stagnated and amounts to only 45% of the total number of income claimants. Social spending has risen to such an extent that state outlays are now 62.5% of GDP (UK 44%). The Dutch social security provides for guaranteed minimum income of about £500/mth!

As the jobless increase this burden grows more onerous causing more unemployment, in a vicious, debilitating circle. The depressed state of the Dutch economy has given it a healthy balance of payments and a subdued inflation rate of 4.2%. B u t : any recovery is going to undermine this surplus. Meanwhile profitability of Dutch industry remains inadequate with no solutions proffered by the right-wing government. Also, says the OECD, the income gap between those who work and those who do not must be made much wider. Greater differentiation between pay for various forms of work, professions and branches is a necessary condition for recovery.

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International s h i p p i n g could find 1983 the most difficult year for half a century. Increasing pressure on freight rates is making life more and more difficult for the shipping firms. Hardest hit are the owners of tankers and bulk goods freighters, but the situation is also constantly worsening for conventional mixed cargo and container shipping.

With a world total of 84m tonnes of unemployed tonnage, the market is at a record low. There are some 1,500 merchant ships under all flags waiting for better times, of which by far the greater number are tankers. End-81 idle tonnage was 27.4m tonnes. Of the total unused tonnage of 84m (more than 12% of total world tonnage) 60m tonnes is in tankers.

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Base metals suffered a setback this week in the wake of falling gold prices. Copper (£1,094), which has been moving up on hopes of a US economic improvement, will be checked from future price escalation because US producers are raising output.

Tin demand is rising and spot tin may become more scarce, in spite of big LME stocks, because these are in firm hands. Also the producer countries are still unable to agree on a cartel (£8,637).

Lead stocks at the LME have reached a record 139,000 tonnes and producion will remain in excess of demand (£297). According to US estimates the lead content of traditional batteries will fall from the current 22.5 lb to 16 lb by 1990 and battery life will be prolonged. Currently batteries account for 55% of total lead consumption. Zinc (£445) is lacklustre on rumours of massive selling orders in London. However, producer prices in the US are expected to rise in the wake of the improvement in the building and car industries.

- Soya is on a rising trend. This year's US and Argentinian harvest will be much smaller, though this is partially offset by improved forecasts in Brazil.

- Cotton prices are marking time. However, the shortage of high quality cotton which is already apparent is likely to become a permanent state of affairs and US official estimates show acreages will be reduced by 20% in 82/83.

Gold has gone into reverse $485. The selling is in response to a market perception that a significant cut in oil prices will lower inflation. Gold fabricators have not wanted to buy, in spite of their low stocks. Private investors have also been cautious after bitter disappointments in 1980/81.

* Platinum is losing its speculative attractions because the upward margin is thought to be exhausted and there is uncertainty over the South African producers' price policy. The buying positions taken up against bear selling of gold (spreads) are likely to be liquidated.

My advice last week to sell silver has been amply borne out by events. There has been a strong reaction to the upset in gold and this may have further to go ($13.25). The silver/gold ratio has declined to 36 to 1 which is close to the average for the decade of the 70s of 32 to 1, so this factor is no longer a prop.

Stock markets. On Wall Street, shares reportedly dropped sharply on fears that a price-cutting war in oil might destabilise the world economy. The more likely reason is that US equities were ready for a correction and oil provided the trigger. Insiders in New York see the growing over-the-counter trade as a sign of froth in the market. The Dow Jones could easily react 10% to 1,000.

IBM @ $98 is a stock to buy on weakness. Analysts are looking for share earnings of $8.20 this year versus $6.99 in 82. The profits are coming from home computers.

The Sydney market is to be avoided. The landslide Labor victory on Feb 19 in a West Australian state election indicates Prime Minister Fraser faces a Herculean task to overcome the unexpectedly strong anti-government mood thus revealed. Prospects of re-election on March 5 are now remote. The time to go back is when a Labor administration has devalued and set up its 'boom-bust' reflation.

The German markets are trading near their historical highs and are discounting a CDU/CSU victory. There is a strong likelihood of a reaction post-March 6.

Lower oil prices and a US economic upturn are an unqualified blessing for the robust Far East mkts, Singapore, Malaysia & Hong Kong. They are the 'best buys' now.

* Elsewhere: Time to buy top class clarets. After a long period of stagnation, values of the best clarets appear to be hardening. Avoid burgundies, brandies and vintage champagnes but an investment in a claret could bring you a good (tax-free) return on a 2-year view.

* Confidence is returning to the Spanish property market. There is a wide variety of apartments, villas and farms on offer in the Costa del Sol, and buying property is now much better organised than it was years ago. There has recently been an upsurge in British interest because of the approaching election and fear of exchange rate controls being imposed.

Pre-Budget tips: scholarship schemes. Following a recent House of Lords decision, schemes that employers operate to provide scholarships for selected children of employees do not give rise to a taxable benefit in the hands of directors and higher-paid employees. The Government may reverse this favourable tax position in the forthcoming Budget and so this may be the last opportunity to award scholarships that are not taxable on the employee.

Some company pension schemes permit employees to make additional payments to increase their pension benefits. Employees should start to make contributions by April 5 83, because they can be deducted when paid. This is provided that an employee's overall contribution does not exceed 15% of earnings, and he or she is to contribute for at least five years.

Yours sincerely,

Donald Lam

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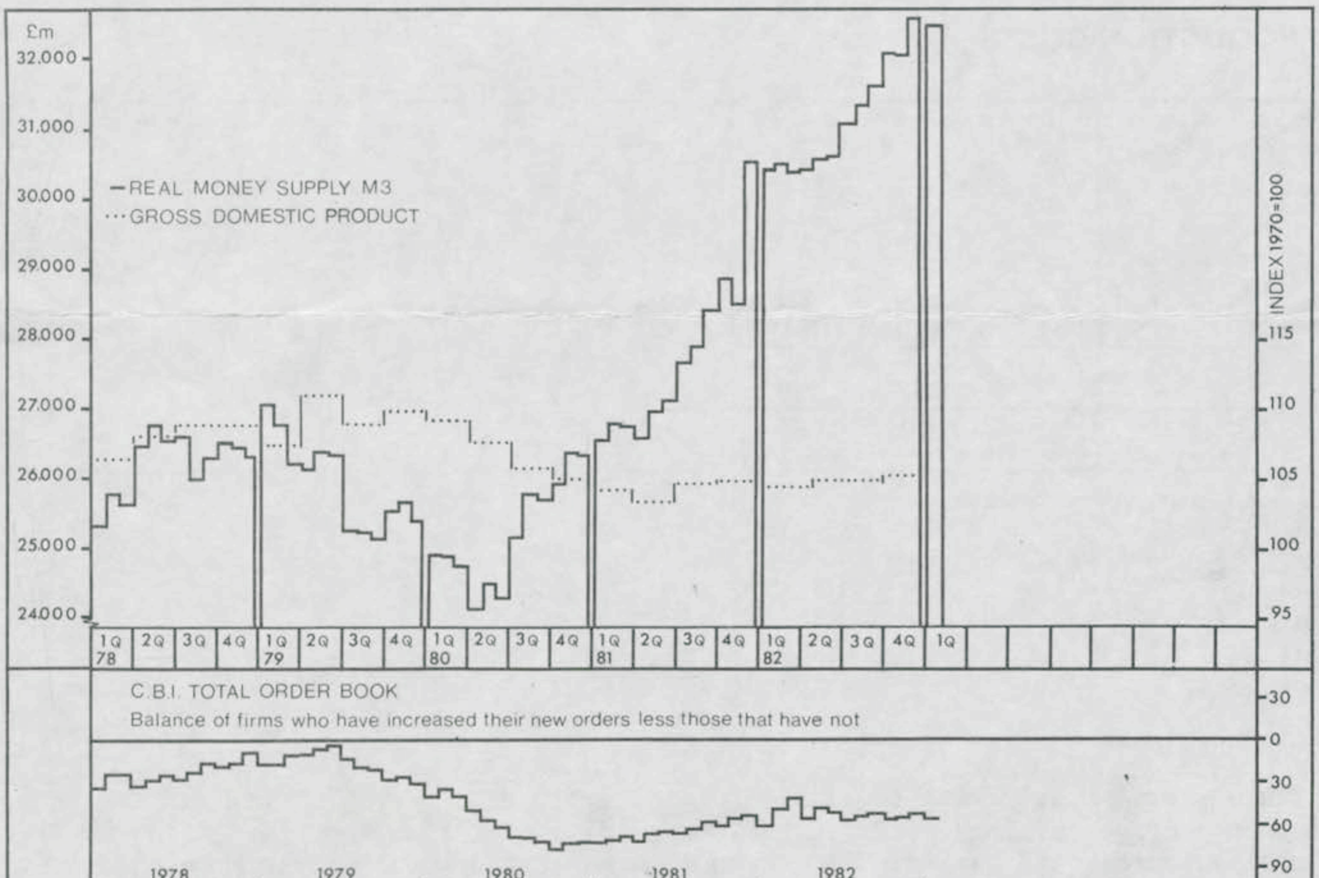
TREND

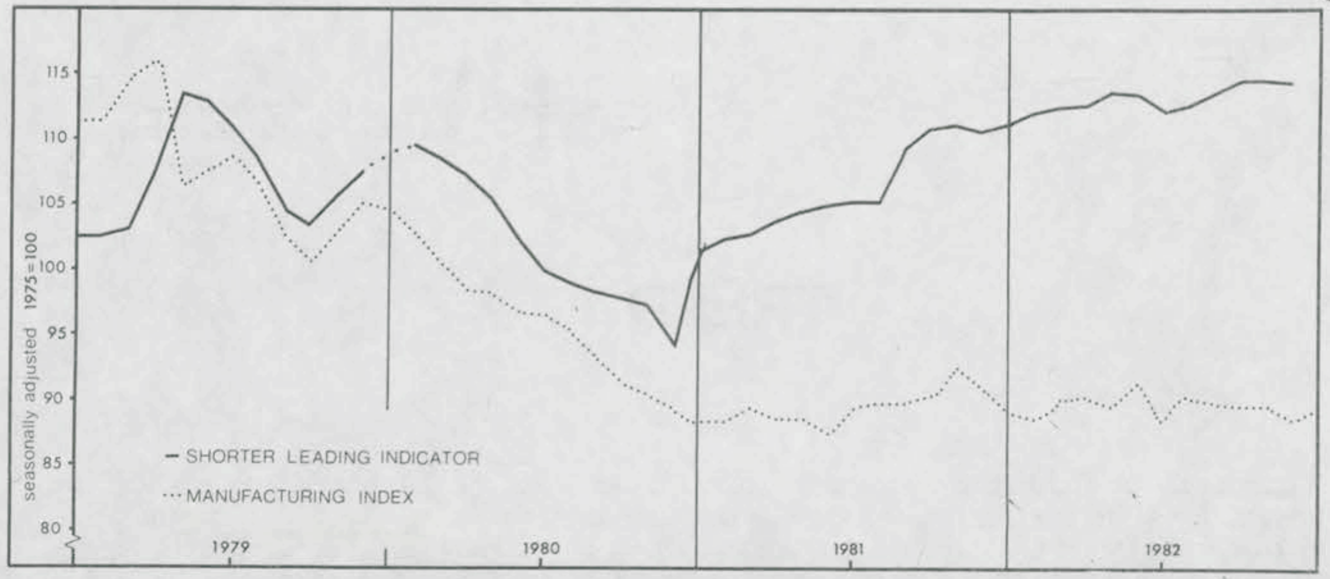
February 83

To appreciate the better prospects for business in 1983 you need to see how much has changed in the last 6 mths. In the world economy, crude oil prices have fallen by some 15% in real terms and short-term US interest rates, which determine corporate borrowing costs, have dropped by well over one third to 8%. In the UK, inflation has more than halved over the past year to 4.9%, while money supply chugs merrily along at a 10.5% annual rate. Sterling has devalued 12.4% on its weighted average basis since last October, more against hard-currency competitors, with a dramatic 23% against the Japanese Yen. It is impossible to be pessimistic against this kind of backcloth, and over the next six months there is likely to be a steady accretion of good news, at least on the consumption front. Investment is more dubious since real interest rates are still very high (8%), nor is there any prospect of the jobless declining. Average earnings are rising too fast in the present state of business and profitability, and the public sector workers (pace the water workers) are showing their usual enthusiasm for pricing other people out of work.

BASIC TRENDS

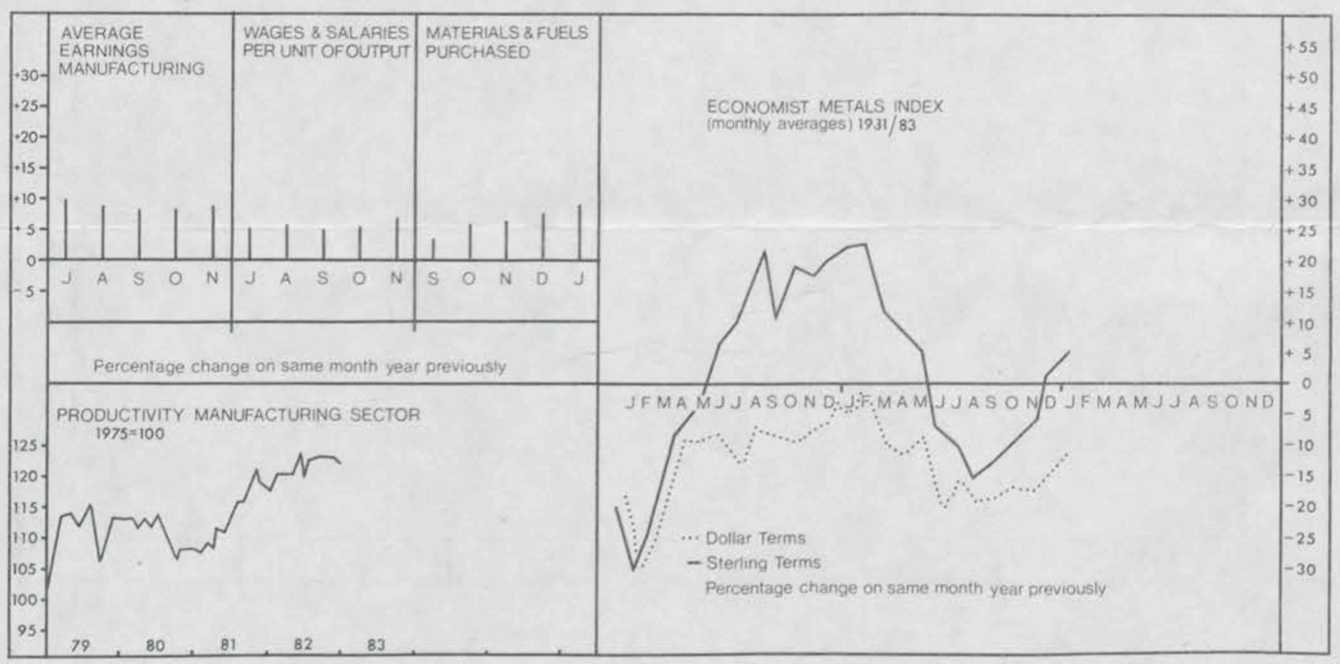


INDUSTRIAL PRODUCTION



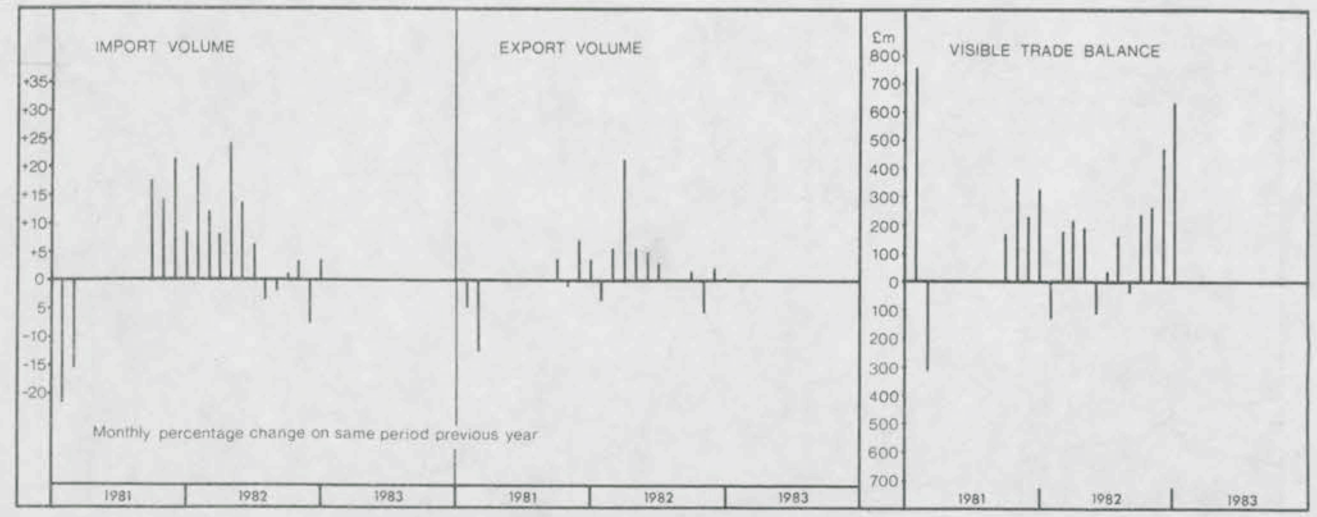
The feature of last year was that the upturn in consumer spending failed to feed through into industrial production. Final 82 figures showed that manufacturing output fell to its lowest level since 1967, 1.2% below 81 and 15% below the cyclical peak in 79. Main reasons are the rundown in stocks and the 8.5% volume rise 82 on 81 in manufactured goods imports. Even Q4's industrial ouput figure was down 0.6% on Q3. Excluding oil the decline between the two qtrs was 1.5%, including a 5.4% fall in metal manufacturing and a 3.2% fall in investment goods output. However the financial background is now much better for companies following the devaluation in sterling and fall in interest rates during 82. Stock levels are now near a cyclical low and export and import volume figures are looking more encouraging. The Treasury forecasts expansion in industrial production over the year of 2%. Mechanical engineering will not be participating: the industry expects a 12% drop in output between 82 and 83.

PRODUCTION COSTS



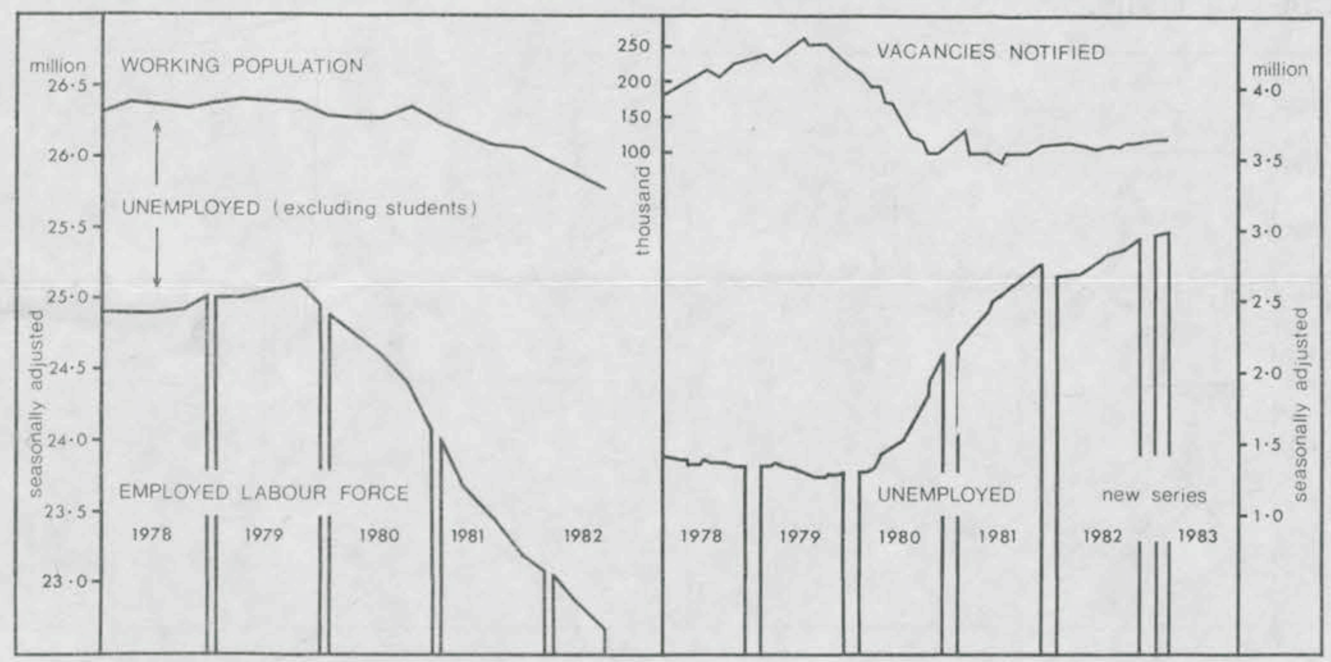
Earnings are still rising too fast, forcing employers to cut labour. In the year to Dec average earnings rose 7.9% - roughly 3% faster than the rise in the RPI. Special factors are estimated to account for a further 0.3% so that the underlying rate of increase - despite 3m unemployed - is 8.2%. Also, except for oil, commodity prices have been rising strongly. Labour and raw material prices will be a negative influence throughout 83 - either squeezing margins or accelerating the RPI.

FOREIGN TRADE



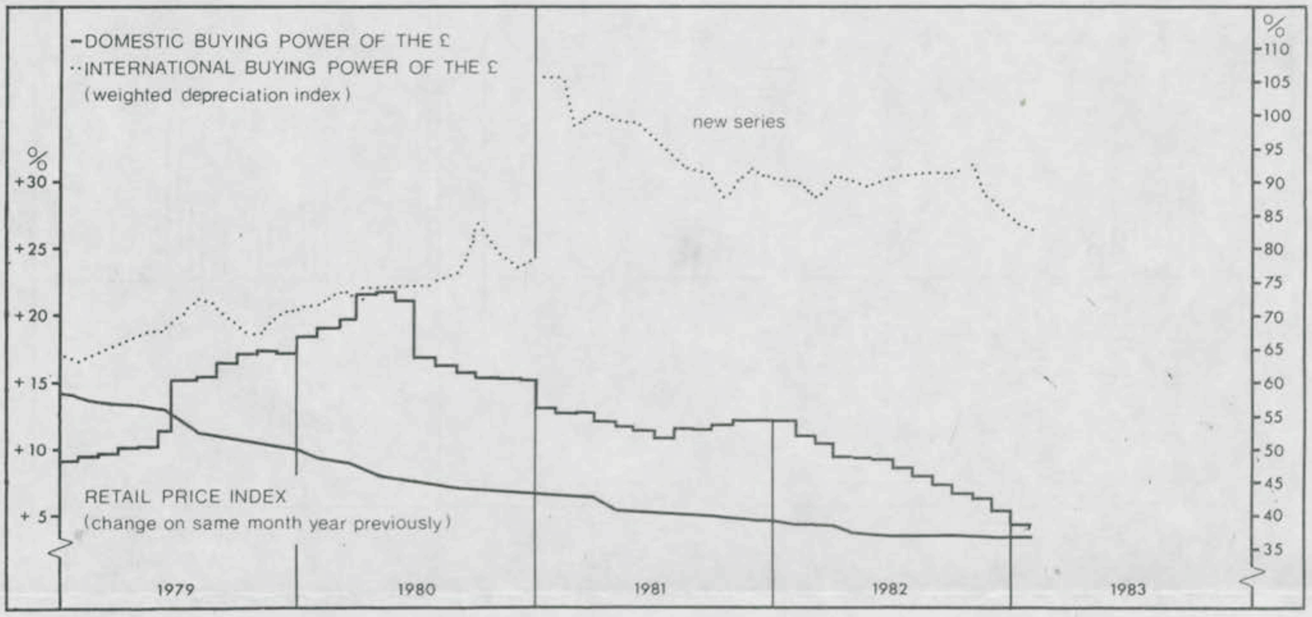
The excellent Dec c/a figures - up £122m to £822m - were entirely due to a £182m improvement in the oil account. This reflected sterling weakness and a 50% fall in oil imports which in turn was due to a warm winter and higher North Sea oil offtake. Nevertheless the remarkably strong c/a performance in Nov-Dec last year took the surplus for the year to £4.6bn, a record among the OECD countries, bar Japan. But the underlying trade surplus of £2.2bn includes a trade deficit in non-oil goods of £2.4bn. The prospects for 83 now look better than the Treasury "rough balance" but this assumes slow UK growth and no oil price collapse. The non-oil trade account is expected to deteriorate to a £5bn deficit, offset by about a £5.5bn -£6bn oil surplus and the usual invisibles surplus.

LABOUR MARKET



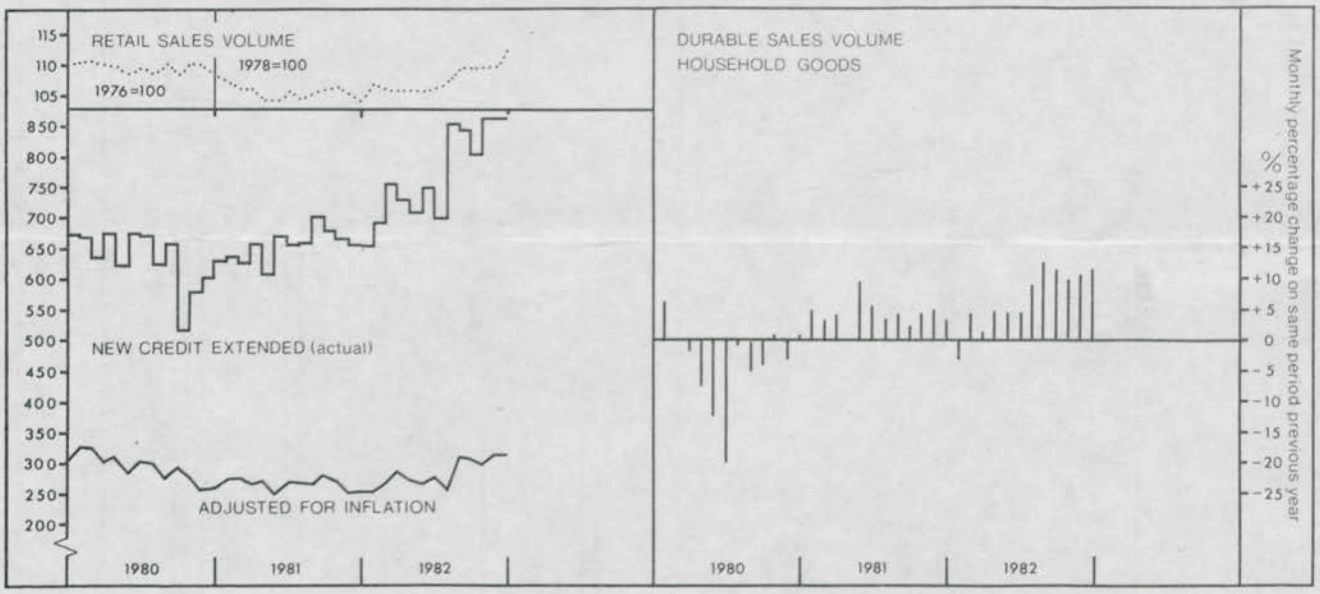
The January unemployment rise (35,000 sa excl school leavers) was the 37th successive mthly rise and took the underlying total to 2.98m, a post-war record. The last 2 mths therefore show a more rapid rise than the average 30,000 seen in the previous 9 mths. The official Treasury "conventional assumption" of an unemployment rise of 280,000 in the next financial year (23,000 per month) indicates only a slight slowing. By end-84 total unemployment (the headline figure) should be over 14% of the working population. Other European countries are now catching up with the UK.

RETAIL TRADE



While spending in Jan at 110 (1978 = 100) was 3% higher in volume terms than Jan 82, it represented a 2% decline on the extremely buoyant Dec 82 figures. However, this represents a temporary pause. Continuing real income gains @ 2% per annum and perhaps £2bn in income tax reliefs in the Budget (including the Rooker-Wise automatic adjustments) point to further consumer spending increases in the first half 83. This should take the retail spending index to an average level of about 112 against Jan's 110. In addition, there are indications of changing patterns of spending. Previously the mini-boom was concentrated in consumer durables, including videos, home computers, washing machines and colour TVs. Now, other sectors such as home furnishings, electrical goods and holidays are benefiting. There is also talk of price rises in electrical goods of 5%-10%, and in furniture and furnishings of 2%-4%.

COST OF LIVING



The 0.1% rise in Jan retail prices was well below expectations, taking the annual inflation rate down to just 4.9% (5.4% to Dec). This means that the annual rate over the past 6 mths is a remarkable 1.6%, against 8.1% in the 6 mths to July. The relatively high mthly figures of 0.66% Feb-July 82 (with a bump around the budget) will now be dropping out of the index so that, arithmetically, further improvement is achievable. The impact of sterling's decline, down 12.4% since end-Oct, has still to feed through on the RPI.

Prime Minister (4)

Interesting but inconclusive.

MCS 17/2

MR. SCHOLAR

EXPORT PERFORMANCE, PRODUCTION, AND THE STATISTICAL CONUNDRA

After some discussion with Sir John Boreham, I think the net result is that the statistical services cannot explain our excellent performance in manufactured exports. They think there might have been a little bit of under-reporting in 1981 which was not adequately corrected for the Civil Service strike, but certainly not enough to offset the splendid performance in 1982.

The combination in the last quarter of 1982 of high consumer spending, low production, low imports, and high exports, has yet to be explained. The obvious explanation, or at least the only one consistent with the statistics at present available, is that there has been a massive de-stocking during the third quarter. On my rough estimates it must be of the order of £600 million.

I am becoming more certain that the statistics are masking a considerable expansion in GDP which is already taking place. Unfortunately, one cannot point to any certain evidence of this, but the combination of statistics suggests that something of the kind must be taking place. Of course we can't go on the record saying anything of the kind; especially in view of the fact that hopes have been dashed so often in the past.

ALAN WALTERS
17 February 1983

MR. SCHOLAR

INTERNATIONAL COMPETITIVENESS AND PRODUCTIVITY

As the Prime Minister suggested, I spoke to Sir John Boreham about my conjecture that the only way to produce consistency between the measures of competitiveness and our export performance was to deduce that we were exporting higher quality goods at no higher prices.

His first suggestion was that there might have been some "trading up" to higher quality exports at the higher prices. But he agreed that this was inconsistent with the evidence. For what we need is actually, for the same quality, a reduction of price, or for the same price an improvement of quality.

One rather frightening alternative was that the statistics were wrong. This could occur if there had been under-reporting of exports in earlier years and full or conceivably over-reporting last year. However it is much more likely that any bias will go in the opposite direction. So I suspect we are safe there. However he agreed to carry out a small investigation to check that this was the case.

He said that his statistical reporting would not reveal any improvements in quality. They tended not to measure that sort of thing. But he did undertake to get in touch with his fellow statisticians in the CBI and other employers' organisations to see what information there was on quality changes.

I think that's about as far as we can take it at present. I will report back to you when I hear more.

AW

9 February 1983

ALAN WALTERS

MR WALTERS

INTERNATIONAL COMPETITIVENESS AND PRODUCTIVITY

I showed your note on this subject to the Prime Minister over the weekend.

She commented that she sees no way of measuring quality increases. But she suggests that the CSO might be able to make some helpful suggestions. May I suggest that you have a word with Sir John Boreham.

M.C. SCHOLAR

7 February, 1983

Prime Minister (2)

To see.

MCS 4/2

MR. SCHOLAR

INTERNATIONAL COMPETITIVENESS AND PRODUCTIVITY

The very remarkable performance of non-oil exports over the last year must, I think, completely discredit all the calculations which have been done by the Bank of England, the Treasury and private institutions measuring our loss of competitiveness. By any of the normal rules of calculation, that is to say, assuming an elasticity of demand for our exports as low as unity, exporting industries would have been completely devastated. Instead of that they appear to be flourishing.

This must mean there is a very serious mis-statement or bias in our economic statistics, and we should try to track it down.

I think we can take it that wages and material prices are measured with fair accuracy. I cannot find any record of any serious discrepency in those measures in the past. However, on the employment side we have the discovery by the Department of Employment the working population in mid-1981 was three-quarters of a million more than they first thought. But this merely confirms the productivity gains in the manufacturing sector. There may, of course, be other revelations about the number of jobs, but I will suppose for a moment that all has been revealed.

The only remaining statistic where the bias can be located is in the production statistics. And there we have some historical evidence of systematic bias, which might well have become a very pronounced bias indeed this last year or two.

The reason is that the production statistics do not adequately account for quality changes. To take a case in point, a Jaguar car today is far more reliable and much better in every way than the same model two or three years ago. Yet in the production statistics they would be shown as exactly the same. But just as we were selling very few Jaguars two or three years ago, now they are selling in enormous numbers in the American and other foreign markets.

Such improvements of quality should be reflected in the production figures. But they are not. I suspect that the tale of the Jaguar is but one of many. I have been hearing anecdotal evidence, not

/merely in the UK,

merely in the UK, but from other coutries, particularly the United States and Germany, of the improved quality of British goods. There must be something in it, after so many years of calumny poured on British quality and reliability.

My tentative explanation then is that the production index has a pronounced downward bias because it does not reflect quality improvements. This explantion then seems to be consistent with all the evidence available - bouyant exports, even increased consumer spending, and the stagnant quantity production figures. I suspect that the quality improvements are mainly shown in the export markets, but they must also spill over onto domestic markets too, and they are likely to be reflected in prices, but of course not "real" prices.

All this does not mean that we cannot explain part of the increase in consumer expenditure in terms of another round of stock reduction. That may well be an additional factor. (I find it difficult to be convinced of this, however, since there has been no increase, and perhaps even a slight decrease in real interest rates.)

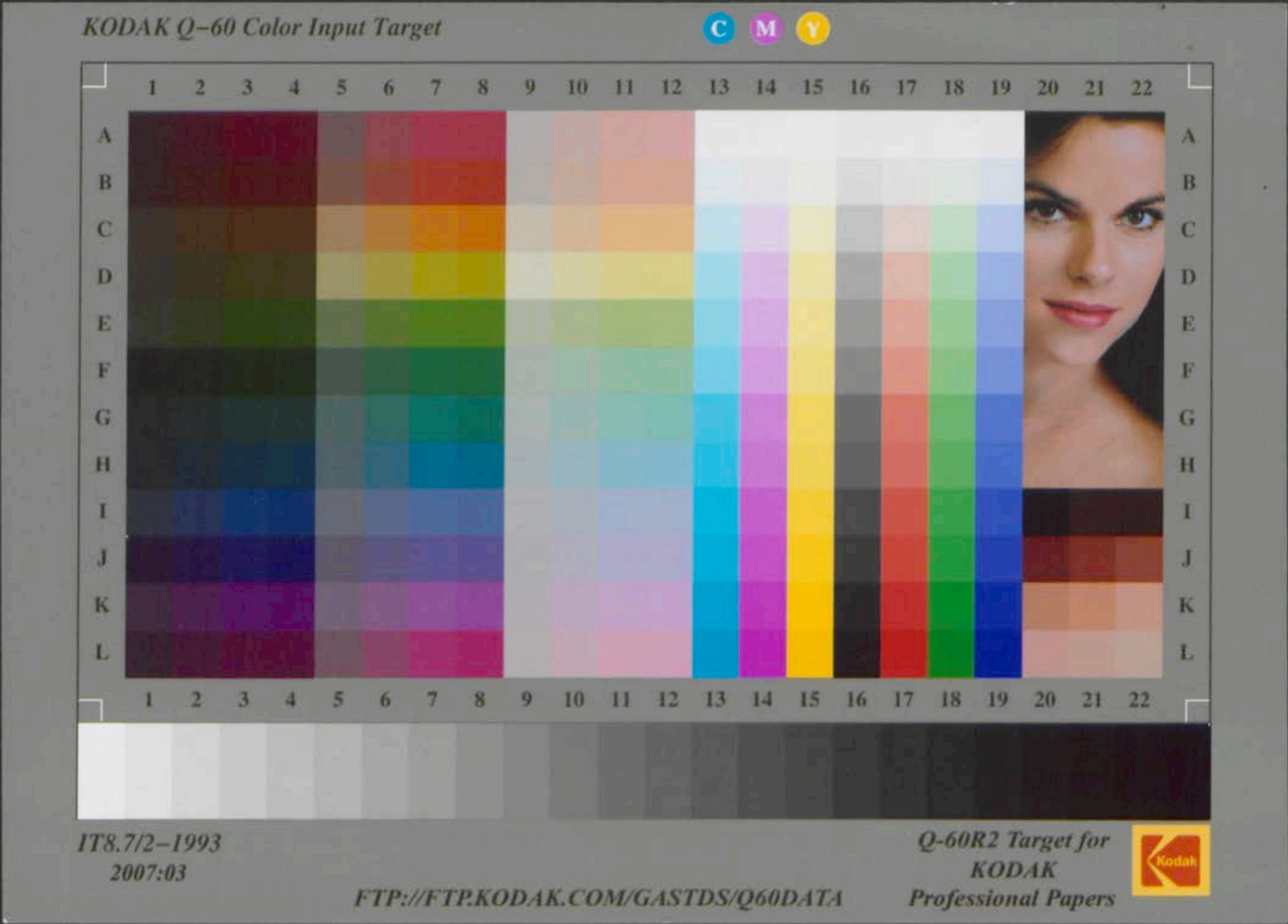
If I am correct in these conjectures, then the economy is in a much better state than is indicated by the production and productivity statistics. We have really turned a corner. Unfortunately, however, not much of this can be used by the Prime Minister.

I don't see a way of measuring 'quality' increase - but CSO may.

28 January 1983

MS

ALAN WALTERS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