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From the Vice-Chancellor: Professor Alan Peacock, DSC MA FBA

2nd April, 1984

The Rt.Hon. Mrs. Margaret Thatcher,
Prime Minister,
10 Downing Street,
LONDON S.W.1.

Dear Prime Minister,

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I must thank you most warmly for inviting me to Chequers on Sunday last. I have taken to heart your suggestions about looking for contract work on employment problems from governmental sources as a way round our inhibitions about taking grant finance. Perhaps David Young might be interested in having us monitor the Enterprise Allowance Scheme once it is further on its way, and I shall be writing to him about this.

I have really been acting as honest broker in trying to establish our Employment Research Centre for I am, strictly speaking, more in the public finance field than in employment. The Fowler Committee on Retirement, of which I am a member, is keeping me very busy and its findings have some bearing on the employment problem, but otherwise I must rely on my colleagues to do the really hard work which the Centre will require.

I have had one sortie into the employment field recently which may be of interest and possibly of help if you are asked on Panorama about socialist proposals to improve employment conditions. My German colleagues are fighting a tremendous battle against the German Unions' demand for a compulsory 35 hour working week as a solution to the employment problem. They asked me to report on the British discussion. I know that you are familiar with the rebuttal of the TUC proposals which closely follow those of their German brothers, but I adopt a slightly different tack from Sam Brittan as will be evident in the attached note. If nothing else, the summary of the empirical evidence on page 7 may be of immediate use.

Yours very sincerely,

Alan Peacock

Alan Peacock

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Written in November 1983

REDUCING THE WORKING WEEK TO IMPROVE EMPLOYMENT -
THE BRITISH DISCUSSION

Alan Peacock

I. Introduction

I come from a country which has had the highest rate of unemployment - over 12% of the labour force - of all major industrial countries and one where, traditionally at least, governments have been much more sensitive to unemployment percentage rates than to inflation. It will therefore come as no surprise for you that the German discussion of solutions to the unemployment problems have their close parallel in the UK. Likewise there is intense disagreement about the aims of economic policy, including the trade-off between inflation and unemployment, the precise ways in which unemployment is caused, and in consequences about the measures which governments should adopt. This disagreement, therefore, is not simply an ideological one, though ideology plays its part.

The reduction in the working week as a method of curing unemployment has had perhaps less prominence in the UK than in W. Germany. It is certainly a major item in the employment strategy of the Trade Unions, as in W. Germany, but it has never been considered a cure-all. As I shall indicate, it is part

of a package of medium term measures built round an essentially Keynesian
view of how the economy works and how its performance should be improved.

On the other hand, the 35 hour week solution has received little if any
support from professional economists including those who have strong sympathy
with the Labour movement.

II. The TUC Proposals

The TUC proposals are dominated by what is sometimes called the 'New
Cambridge' view of the economy. The economy should be kept in a state of high
aggregate demand as a way of stimulating output, a large part of this demand
originating in the public sector in the form of infrastructure investment,
energy and housing. The balance of payment effects of demand would be dealt
with by selective import controls and by the use of the exchange rate as a
policy instrument, ie. devaluation. Competitiveness abroad, therefore, depends
on the manipulation of the exchange rate. Competitiveness at home is not a
necessary prerequisite for efficiency which depends upon coordinated government
planning of industry. This is a familiar form of argument, and I have no
intention on offering a critique on it.

At the same time, the TUC view of the economy accepts that high
aggregate demand and the hoped-for economic growth which accompanies it will
not ensure a satisfactory level of employment by itself. In their economic

review for 1983, entitled The Battle for Jobs, a target is set for the creation of 3.5 million extra jobs. If there were no reduction in working time, so it is claimed, this target would require an annual growth in output of 5%, consisting of a growth in employment of 3% per annum and 2% annual average growth in productivity. However, the employment target could be met with less onerous productivity growth requirements if working time were reduced. To quote this document:

"If some of the benefits of increased productivity were taken in increased leisure as opposed to extra incomes for those in work, then each increase in output would create proportionately more employment. More workers can clearly be employed if they are working 35 hours per week, with no overtime, as happens too often at present. The TUC's objective is therefore to reduce working time by 10 per cent over 5 years The TUC estimates that given changes in working practices and increased production, one half of this reduction in working time would go towards increasing employment."

and later:

"Reduced working time will thus play a key role in distributing the benefits of new technology".

III. The Economic Analysis of Reduced Working Time

I should like to distinguish three cases embodying different assumptions about what would happen if working time were reduced along the lines suggested by the TUC.

In the first case, there is voluntary negotiation of working time arrangements. Presumably, both employers and employees seek to exploit any gains from such an arrangement. Effectively, the employees seek a higher rate of pay per hour to compensate for fewer hours work and employers will accede to their demands, presumably, if there is a sufficient compensating increase in productivity per man hour. This kind of bargaining is a common, if short-run, phenomenon in the labour market. However, such a voluntary arrangement, while it may benefit existing employees, will not necessarily create more jobs. In the long run, the increase in the price of labour may also represent an increase in its price relative to the price of capital inputs, and employers may, subject to substitution possibilities, replace labour, at the margin, with capital.

In the second case, there is an officially introduced shorter working week and overtime is not permitted or is restricted. The implication is that the existing employed work shorter hours and are replaced by unemployed to 'make up the difference'. This assumes that there is a

'lump of labour' which employers will hire which is independent of any change in costs as a result of the 'work sharing' arrangement. But there is a presumption that unit labour costs will rise. There is also a presumption that the unemployed are less skilled than those in employment and more persons on the payroll normally means more per capita social security charges. Both these raise prices of products, cut demand and therefore output and employment. There is another important characteristic of this model. Work-sharing here implies income sharing. While the total real wage bill may not fall, the increase in the numbers of employed means a redistribution of income between the employed and formerly unemployed. In the UK at least, manual employees (male) work by far the most overtime, but they are generally among the lower-paid. Thus the relatively poor workers would be the hardest hit by an income-sharing arrangement introduced in the name of increasing employment.

In the third and final case I consider, we approach more closely the ideal sought by the TUC - there is an officially introduced shorter working week but employees are induced to accept it by the prospect of no reduction in take-home pay. All we have done here is to add another factor which would reduce the demand for labour on top of those mentioned

in the second case, for unit labour costs would automatically rise.

In such circumstances employers would be bound to press ^{for} productivity improvements as the price of raising hourly wage rates, but the more they were successful, the less would be the 'employment effect' of shorter hours, as the TUC realises.

IV. Empirical Findings

There is no government policy in the UK which makes it mandatory on companies to promote reductions in working time. Official policy has been concentrated on support for 'work-sharing' arrangements but these arrangements are not approved of by the TUC. On the other hand, a considerable number of industrial establishments have negotiated with trade unions national agreements, that is to say agreements which apply throughout the industry concerned, on a shorter working week. Examples of such industries are engineering, pharmaceuticals, printing and construction. These agreements, many of them now in operation for nearly three years, have been subject to close examination as to their employment, productivity and other effects.

It is only possible in this context to give a bald summary of the findings of the empirical work, most of which has been carried out in the

Policy Studies Institute, London, at the request of the UK Department of Employment. The main findings were:

- (i) There is no evidence that reductions in working time resulted in increased employment.
- (ii) Firms and unions preferred to negotiate productivity agreements as an offset to reduced working time, and to allow some increase in overtime for existing employees.
- (iii) These results were also compatible with the finding that managements considered that there had been no 'trade-off' of shorter working hours for a moderation in demands for wage increases. There was no evidence, therefore, of income sharing as a means of creating additional employment opportunities.
- (iv) On balance shorter working hours were associated with higher labour costs per unit of output and something like a quarter of the companies covered were concerned about the effect of rising labour costs on their competitiveness and therefore their ability to avoid laying off employees.

V. Conclusions

It is logically correct that so long as an x per cent reduction in working hours leads to a less than x per cent reduction in output, then there is scope for some increase in employment, assuming that

hourly rates of pay are constant. However, even with hourly rates of pay constant, there must be some rise in unit labour costs, and this probably means that 'second round effects' will produce rises in prices, thus lowering demand for exports and increasing demand for import-competing goods. Thus under the most favourable conditions, a reduction in working hours, by itself, will have at best a limited effect on employment.

All the evidence in the UK suggests that unions negotiating for shorter hours do not expect the 'trade-off' with employers to take the form of a fall in take-home pay, that is to say they expect their real income to increase through a rise in hourly rates of pay. The trade-off is more likely to take the form of concessions on improved productivity. Unless the employed are willing to sacrifice real income, and in practice this has simply not occurred in the UK, then there is little prospect of a 35 hour working week having more than a marginal effect on the reduction of unemployment.

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6 April 1984

The Prime Minister was most grateful to you, first for coming to Chequers for the discussion last Sunday, and secondly for the material you sent on the working week. She will no doubt have opportunities to deploy these arguments and the empirical evidence, if not on Panorama, then certainly elsewhere.

ANDREW TURNBULL

Professor Alan Peacock, DSC
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