



10 DOWNING STREET

From the Private Secretary

4 February 1985

The Prime Minister has asked me to thank you very much for your letter of 25 January, and for sending her a copy of "Employment Trends in Britain and the USA". She was most interested to see this.

(David Barclay)

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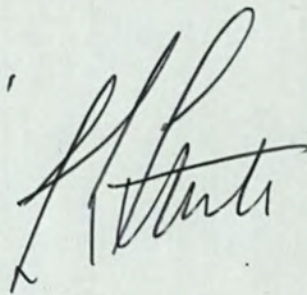
Prime Minister,

25th January 1985

Dear Prime Minister,

I watched your ITV interview last night. Burnett questioned you on the decline in output of manufacturing industry. I think you might have been better briefed, and so I enclose a copy of "Employment Trends in Britain and the USA" in which it is argued that real wage flexibility in the USA (as against the U.K.) has enhanced its competitive edge in world markets.

Yours respectfully,



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EMPLOYMENT TRENDS IN BRITAIN & THE USA

Introduction

The question is as old as the hills and at least as enduring. Ever since the benefits of the division of labour led to the production of goods for exchange, rather than for self-sufficiency, people have been concerned about their security of employment. Essentially, they have worried about the possibility of falling demand for the particular "product" they supply or the possibility of that product being produced without them, (the latter fear usually being associated with anxieties about technological developments).

Unfortunately, it has hardly, if ever, been possible to forecast in any specific detail where the next generation's jobs will come from. Two hundred years ago, the majority of people were employed on the land; neither they nor their employers could have envisaged a situation in which the majority would be employed in industrial occupations. Equally, few would have forecast in the mid-nineteenth century that, by the second half of the twentieth century, the major share of employment in the "industrial" world would be in "services". Even now, it comes as something of a surprise to find that almost two-

thirds of total employment is in that sector. The market has transmitted altered demands and, together with the pattern of cost structures throughout the world, has determined how people should be employed.

Industrial change is therefore a central aspect of an efficiently functioning economy. In a world of advancing technology and continually changing patterns of demand, the quicker the response the better. The problem is that frequent change to their working lives is, understandably, not welcomed by the majority of people, and worse still, if responding to the demands of the market involves a period of unemployment or a reduction in remuneration, it is doubly unwelcome.

Employment Trends in Britain

However, even though the British economy does not have the reputation of being a rapidly changing economy, at least compared with other industrial nations, the record shows that over time it certainly does change (see table 1).

Just before the Second World War, 52% of employment in Great Britain was in industrial production and 43% in "services". Even by the late

Table 1 Employment in Great Britain (1939-83)

(thousands)	1939	1949	1959	1969	1979	1983
Manufacturing	6,815(38%)	8,229(38%)	9,169(39%)	8,181(37%)	7,053(31%)	5,346(27%)
Construction	1,310	1,438	1,509	1,415	1,252	965
Mining + Quarrying	873	875	823	434	347	311
Gas, Elect. & Water	242	334	374	397	338	323
INDUSTRIAL PRODUCTION	9,240(52%)	10,946(50%)	11,875(51%)	10,427(47%)	8,990(40%)	6,945(34%)
National & Local Govt.	1,385	1,392	1,307	1,432	1,564	1,495
Distribution	2,887	2,553	3,000	2,652	2,813	2,640
Other Services	3,458	5,674	6,074	7,159	8,863	8,761
TOTAL "SERVICES"	7,730(43%)	9,619(44%)	10,381(45%)	11,243(51%)	13,240(59%)	12,896(64%)
Agriculture, Forestry & Fishing	950(5.3%)	1,176(5.4%)	999(4.3%)	479(2.2%)	358(1.6%)	339(1.7%)
EMPLOYEES IN EMPLOYMENT	17,920	21,741	23,255	22,148	22,588	20,180

Sources: Annual Abstract of Statistics; Dept. of Employment Gazette.

fifties, this pattern had not changed much — 51% and 45% respectively — partly because this period coincided with a temporary increase in the United Kingdom's share of world manufactured trade. However, "industrial" employment began falling quite sharply in the sixties — both in absolute numbers and as a proportion of total employment. The reasons for this contraction — which is still going on — were twofold: first, principally because of technological change, manufacturing productivity is relatively easy to raise — it increased by 57% between 1962 and 1973 — and second, Britain's share of world manufacturing production was reduced by the impact of foreign competition (from the newly industrialised countries as well as the developed economies).

In contrast to the record in manufacturing, employment in services grew quite quickly in the sixties and seventies, accounting for 51% of employment by 1969 and 59% by 1979. In total, the service sector generated almost 3 million new jobs between 1959 and 1979. These increases in service employment were almost counterbalanced by the disappearance of jobs in the "industrial" and agricultural sectors. With the working population increasing by 1.7 million over this period, the other significant development was the rise in unemployment from about 400,000 in the

late fifties to just over a million in the late seventies.

In the eighties, the increase in public sector employment has been put into reverse as a matter of policy, the decline in manufacturing has accelerated and, for the first time since the Second World War, employment in other services has fallen. The net result has been another substantial increase in the United Kingdom's unemployment (from 1.2 million in 1979 to 3 million in 1983).

Table 2
Manufacturing Employment Comparisons (1974 and 1983)

(thousands)	Employment		Output
	1974	1983	% change
Food, Drink & Tobacco	740	611	-17%
Chemical & Allied	471	363	-23%
Metal Manufacture	507	259	-49%
Metal Goods	577	365	-37%
Engineering & Allied*	2129	1678	-21%
Motor Vehicles	509	307	-40%
Other transport equipment	244	195	-20%
Textiles, Clothing & Footwear etc.	992	567	-43%
Paper, Printing & Publishing	582	473	-19%
Other Manufacturing	923	718	-22%

Sources: D.E. Gazette; Monthly Digest of Statistics; ton 1968 S.I.C. basis; *including shipbuilding.

Manufacturing

Between 1974 and 1983, manufacturing employment declined at almost twice the rate at which output fell (30% compared with 16%). The fastest falls in employment over the period were in metal manufacture; textiles, clothing and footwear; and motor vehicles — industries which are not in decline everywhere. The textile industries have been drawn to the cheap labour countries, and the motor and metal industries to the highest productivity countries.

Services

Employment in the service sector increased by about 1/2% per annum between 1974 and 1983 but within that overall trend, there were wide differences. Employment in financial services has increased by one fifth — banking increasing by 24% and insurance by 9%. Also within this category, employment in "other business services" has increased by 23%; the important identifiable sub-sectors within this category are "activities auxiliary to banking and insurance" (about 90,000); hiring of equipment etc. (about 90,000); estate agents (about 70,000) and computer services (about 60,000). Obviously, a proportion of those employed in some of these "services" are indirectly involved in the production of goods — e.g. the computer programmers who write the software for industrial robots.

In terms of sheer numbers, the "professional and scientific" services are dominated by medical/dental services (which are growing rapidly) and education (which, largely because of demographic factors, is not), but the fastest growing areas are the law and accountancy (+34%).

Elsewhere in the service sector, wholesale and retail distribution account for 2.6 million jobs and hotels/catering for almost a million, but the fastest growing sectors are in "recreation, sport and entertainment" (+37%), which includes the potentially important radio, films and t.v. sub-sector. The "other miscellaneous" services (+26%) include the social services (almost half a million).

As table 3 shows, the largest proportionate declines in demand have been in transport (where increasingly, we drive ourselves rather than pay others to do it) and laundries/cleaning (the

Table 3

Service Employment Comparisons (1974 and 1983)*

(thousands)	1974	1983	Changes 1974-83 (000)	(%)
Transport	1049	886	-163	-16%
Communications	434	419	-15	-3%
Wholesale Distribution	829	829	n.c.	n.c.
Retailing	1878	1810	-68	+4%
Financial Services	1101	1326	+225	+20%
<i>of which:</i>				
Banking & Finance	409	509	+100	+24%
Insurance	262	287	+25	+9%
Other Business Services	430	530	+100	+23%
Professional & Scientific Services	3284	3668	+384	+12%
<i>of which:</i>				
Medical & Dental Services	1130	1398	+265	+23%
Education	1693	1740	+47	+3%
Legal/Accountancy Services	187	250	+63	+34%
Research/Development	106	110	+4	+4%
Other	168	170	+2	+1%
Hotels & Catering	795	923	+128	+16%
Garages & Motor Repair	426	466	+40	+9%
Recreation, Sport & Entertainment	277	380	+103	+37%
Hairdressing	89	86	-3	-3%
Laundries & Dry Cleaning	86	60	-26	-30%
Other Miscellaneous Services	421	546	+125	+30%
Public Administration	1551	1540	-56	-4%
TOTAL SERVICES	12,220	12,895	+675	+5.5%

*estimated on 1968 S.I.C. basis

Sources: D.E. Gazette; Census of Employment.

market for which has fallen as the incidence of washing machines, vacuum cleaners etc has increased).

After falling between 1973 and 1979, the number self-employed — most of whom are in services of one kind or another — has since increased from about 1.9 million to 2.3 million in 1983. However, the total employed labour force still fell between 1979 and 1983 and more importantly, the rate of unemployment was on a consistently rising trend.

Just Part of a World Problem?

Why has the British economy failed to generate sufficient jobs to prevent this substantial increase in unemployment? The general recession of 1980-81 and Britain's loss of international competitiveness over a range of long-established industries provide a partial explanation, and its critics maintain that the Government has pursued too restrictive an economic policy. However, the primary question is whether or not Britain's experience has been different from that of other similar countries.

In all the developed economies, "industrial" employment has been falling in proportionate terms over the last ten years or so but there are marked differences between certain countries: industrial employment still accounts for 42% of total employment in West Germany but only 28% in the USA (see table 4). The proportion employed in this sector is very similar in the United Kingdom, France, Italy and Japan.

All the OECD countries have experienced sharply increased levels of unemployment since the first "oil shock" of 1973/4, but it has increased much more than the "average" in the United Kingdom and West Germany and much less in the USA, Japan and Italy.

The differing levels of unemployment have clearly been a reflection of individual countries' flexibility and their overall economic success or lack of it; generally, those countries that have achieved the best rates of economic growth have been able to contain the rise in unemployment better.

Lessons From America?

During the last ten years, West Germany and Japan have gained market share in manufactured goods at the expense of the USA and the United Kingdom. Apparently reflecting this, the United Kingdom's employment situation has deteriorated more or less consistently whereas in the USA, the total number of jobs has increased substantially (not least, during the last two years even though the dollar has been so strong). Clearly, this is not simply a question of greater "competitiveness" vis-à-vis other countries, it is also a matter of labour being competitive with capital and with the option of simply leaving potential workers idle.

Table 4

OECD Employment in the Major Sectors* in 1974 and 1983

		UK (%)	USA (%)	W Germany (%)	France (%)	Italy (%)	Japan (%)
Agriculture	1974	2.8	4.1	7.3	11.6	16.6	12.9
	1983	2.7	3.5	5.6	8.3	12.4	9.3
Industrial Production	1974	42.3	31.0	47.3	39.2	44.1	37.0
	1983	33.6	28.0	42.0	34.2	36.0	34.8
Services	1974	54.9	64.9	45.4	49.2	39.3	50.1
	1983	63.7	68.5	52.4	57.6	51.6	56.0

* OECD definitions of sectors.

Source: OECD "Labour Force Statistics".

The important wage rate is the market clearing rate — i.e. the rate at which all workers willing to work could actually find employment — and that rate will be different in different areas, industries and times. It is the flexibility of the US labour market, where real wages go down as well as up, according to prevailing conditions, that has allowed America to have rising employment even when its international "competitiveness" has declined. The various "de-regulation" measures, the lower proportion of the workforce in trade unions and the relatively small public sector have probably all been relevant in this context.

Certainly, the USA seems to have coped much better than Britain with the problem of generating employment, even though its civilian labour force has increased by 23% since 1974, whereas that of the United Kingdom has grown by only 4.5%. While US private sector employment has increased by 18.5% (11.8 million jobs), United Kingdom employment has fallen by 9% (nearly 2 million jobs). Manufacturing employment has fallen in both countries, but to a very much greater extent in this country — 29% compared with — 3.6%. In the non-manufacturing sector, Britain has generated only 265,000 new jobs (+1.8%) to fill the gap left by manufacturing whilst the USA has generated more than 12.5 million new jobs (+28.6%) in that sector. The result has been a quadrupling of our unemployment rate whilst that of the USA has not even doubled.

Although it would have been impossible to forecast exactly where the US jobs 'boom' would occur, the key to this divergence probably lies in the differing rates of real wage growth. Between

1976 and 1983, US private sector earnings rose by 64% and prices by almost 75% — producing a “real” decrease of 6%. In Britain, earnings rose by 128% over this period and prices by almost 113% — giving an increase in “real” earnings of 7%. Not only did this outcome result in a much higher level of United Kingdom inflation — contributing significantly to loss of market share at home and abroad — but it greatly encouraged the use of capital equipment in substitution for labour wherever possible (in contrast to the way the balance was shifting in the USA). This incentive to utilise capital rather than labour was increased further in the United Kingdom by the various investment allowances/grants available.

The contrast with the USA is clear enough in the manufacturing sector — an increase in “real” wages of 9.3% in this country, compared with a 2.8 per cent fall in the USA over the period 1976-83. In simple terms, in the USA, the so-called “inevitable” decline in manufacturing employment has been lessened by the acceptance of marginally falling real pay, whereas in the United Kingdom, it has been accelerated by significantly higher real wages and investment incentives.

In the non-manufacturing sector, the same influences can be seen at work but the contrast

between the United Kingdom and the USA is even more significant. Over the period 1976-83, real earnings in non-manufacturing fell by 6.7% in the USA whilst in Britain, they rose by 6.4%. Although cause and effect can be only inferred from this data, it does suggest that the demand for more labour in the non-manufacturing sector in the USA and the absence of it in this country, were in some close way related to the divergent movements in the rates of increase of real wages. Because productivity growth is usually — by its very nature — much slower in the labour-intensive “services” than in manufacturing, it could be said that the USA has consistently “mopped up” the labour unable to find employment in the manufacturing industries by utilising it in other sectors — at lower levels of productivity and at lower levels of pay. This interpretation seems to be confirmed by the relatively low pay in the US service sectors: in distribution (where employment has increased by 2.8 million in the last seven years), average hourly earnings are only 73% of those in manufacturing; in financial services (where employment has increased by 28%) and other service industries (where employment has increased by 35%), the ratio is 82%. In the USA, employment has grown rapidly in all

Table 5

Employment & Earnings in US and GB Industries 1976-1983*

	US Employment**		% change† in Real Earnings	GB Employment		% change† in Real Earnings
	(millions)			(millions)		
	1976	1983		1974	1983	
Manufacturing	19.0	18.6	- 2.8	7.1	5.3	+ 9.3
Non-manufacturing	45.5	55.5	- 6.7	14.9	15.0	+ 6.4
<i>of which:</i>						
Construction	3.6	3.9	-11.7	1.3	1.0	+ 8.6
Mining	0.8	1.0	+ 0.2	0.3	0.3	+14.0
Transport & Communications	4.5	5.0	- 4.1	1.5	1.3	+ 9.5
Distribution/retail	17.7	20.5	- 6.5	2.7	2.6	+ 7.5
Financial Services	4.3	5.5	- 4.8	1.1	1.3	+19.5
Other Services	14.6	19.7	- 4.8	7.4	7.6	+ 5.6
TOTAL	64.5	74.1	- 6.0	22.0	20.2	+ 7.1

*longest period for which compatible series are available

**figures for USA — private sector non-agricultural employment

†change in nominal earnings deflated by consumer price index.

Sources: US Dept. of Commerce “Survey of Current Business” IMF “International Financial Statistics”

D.E. Gazette; Consensus of Employment.

these sectors (particularly in the last eighteen months).

Of these sectors, only employment in financial services has grown almost as fast in Britain as in the USA in recent years whilst employment in distribution has fallen marginally (despite a very large increase in retail spending) and that in "other services" has fallen by 3%. Expressed as a proportion of wages in UK manufacturing, average male wages in financial services are 96%, in distribution 82%, and in other services 86%.

Regulated minimum wages apply to about two-thirds of Britain's employment, with statutory wages council rates applying to another 15%. The effect of these regulations is to deny the least skilled — especially the young — the chance to work at all because the value of their contribution to potential employers is less than their cost, as dictated by the minimum wage rates. At the lower end of the labour market, Britain's social security benefits also set an effective 'floor' to wage levels. Although the results are not so dramatic, the effects of similar "rigidities" in the rest of the labour market are essentially the same.

Conclusions

No confident answer can be given to the question posed in the title of this article but certain pointers stand out. First, the new jobs are unlikely to come in manufacturing; a reduction in manufacturing employment is being experienced in every developed economy. As people become better off, they spend proportionately less of their increased incomes on goods and proportionately more on "services". The downward trend in manufacturing employment must therefore be expected to continue, especially since the impact of semi-conductors — in particular in the form of industrial "robots" — will render labour progressively less necessary for industrial production. Second, the rate at which service employment expands to "fill the gap" depends on the price demanded by labour to work in these sectors. If that price is high, the cost of the "product" to the potential purchaser may be too great; in addition, it may make better sense to use capital equipment rather than labour to supply it. If labour markets are flexible — in particular with regard to pay being more in line with labour's value to the

Table 6

Service Employment in the USA: Detailed Analysis
(000)*

	1974	(%)	1982	(%)	% Change 1974-82
Hotels etc.	919	(5.9)	1158	(5.7)	+26%
Business Services	2112	(13.6)	3304	(16.2)	+56%
Personal Services	862	(5.5)	934	(4.6)	+ 8%
Autorepair etc.	666	(4.3)	881	(4.3)	+32%
Motion Pictures	203	(1.3)	214	(1.0)	+ 5%
Amusement etc.	589	(3.8)	812	(4.0)	+38%
Health Services	3867	(24.9)	5814	(28.5)	+50%
Legal Services	316	(2.1)	567	(2.8)	+78%
Education	1159	(7.5)	1317	(6.5)	+14%
Social Services	2193	(14.1)	2702	(13.2)	+23%
Misc. Prof. Services	758	(4.9)	1082	(5.3)	+43%
Private Households	1903	(12.2)	1635	(8.0)	-14%
TOTAL	15,550	(100)	20,420	(100)	+31%

* Full-time and part-time employees.

Source: US Dept. of Commerce "Nat. Income/Product Accounts".

"production process" — there is no need for "de-industrialisation" or labour-saving technology to lead to permanent high levels of unemployment, (as the US experience seems to have demonstrated). Living standards will of course remain very much dependent on manufacturing success and efficiency, since if we are to continue to indulge our relatively high propensity to import manufactured goods, we must have something to export, but the level of unemployment will be determined more by the effectiveness with which we marry the undoubted demand for services — both those traded internationally and those that are not — with a willingness to accept realistic levels of pay for supplying them.