No Imminent Collapse Of British Economy... But Recovery Impossible Under Present Conditions

BRITAIN

The British economy is likely to be one of the few national sectors in the West not to show a major collapse in the next period — but only because there has been no significant recovery from the depths of the 1975 depression. The residue of the sterling crisis, continued scarcity of investment capital for industry in Britain, and the collapse of the international monetary system and world trade will prohibit any possibility of a significant upturn in domestic industrial activity. Despite the principled intention of the Callaghan government to regenerate the British economy, the government's failure to propose a coherent policy to achieve this end will make any economic recovery impossible.

The government's fuzziness on economic problems is exemplified in the budget announced by Chancellor of the Exchequer Denis Healey March 29. Healey announced various tax cuts, gas and cigarette price increases, pension increases, etc., in an attempt to satisfy trade unions, industry, and the IMF alike, while never once hinting at the basic problems which are inhibiting industrial recovery.

Ironically, just when all classical economic predictions, and objective economic circumstances indicate British industry should be perched to undertake a massive growth in industrial output (this optimism is mirrored amply in the forecasts of both the Department of Trade and Industry and the Confederation of British Industry), industry is struggling to mount a recovery which at best will put it close to 1973-74 production peaks.

Current Trends and Official Forecasts

Recently published basic indicators of the British economy appear to hold some hope for at least a limited recovery in the next one to two years. The index of industrial production shows an even, if slight growth pattern consistent with government projections of a modest growth rate; exports, boosted by the falling value of the pound in late 1976 are rising in volume terms at a rate faster than imports; fixed capital expenditure is also registering slight increases. The ace in the hole, North Sea oil, has spurred the government, as well as most economic commentators from the Bank of England to the Cambridge Economic Policy group to forecast a drop in

Basic Economic Indicators: U.K.

	INDUSTRIAL PRODUCTION 1970=100	UNEMPLOYMENT THOUSANDS	UNEMPLOYMENT PERCENT TOTAL EMPLOYED	PRICES RETAIL 1974=100	PRICES WHOLE-SALE 1970=100	VISIBLE TRADE (BY VOLUME) 1970=100 EXPORT	VISIBLE TRADE (BY VOLUME) 1970=100 IMPORT	CHANGES IN MANUFACTURING STOCKS AT 1970 PRICES END 1975 £10.4 Bn	FIXED CAPITAL EXPENDITURE (MANU-FACTURING) AT 1970 PRICES MILLIONS OF POUNDS
1970	100				100.0			325	
1971	100.5	775.8	3.4	153.4**	104.6	106.7	104.2	-148	2,130
1972	102.7	854.9	3.7	164.3**	109.2	106.6	116.3	-145	1,991
1973	110.3	611.0	2.6	179.4**	144.5	121.8	133.9	404	1,739
1974	106.4	599.5	2.6	108.5	215.3	130.1	135.2	666	1,872
1975	101.2	929.0	3.9	134.8	235.4	124.9	125.6	-392	2,024
1976 I	102.1	1,223.2	5.2	149.4	266.5	130.3	124.9	31	1,737
II	102.4	1,246.5	5.3	154.9	292.6	135.9	134.7	-115	402
III	101.5	1,307.5	5.5	158.5	306.8	133.1	136.6	5	408
IV	102.9	1,330.0*	5.6	165.8	329.2	139.9	137.2	95	411
1977 JAN	103.9	1,338.2	5.6	172.4	338.2	140.0	153.7		
FEB		1,331.4	5.6						

* FIGURE FOR DEC., 1976

** BASED ON JAN. 1962=100

SOURCE: DEPARTMENT OF TRADE AND INDUSTRY inflation rates to 8 percent by 1978, assuming the continued depression of wage demands through the social contract.

Forecasts for industrial recovery are equally optimistic. According to the CBI's latest survey of its members on their fixed capital investment plans, 4 percent expected to increase plant capacity (as opposed to 12 percent a year earlier who expected to decrease capacity) and 29 percent planned to invest in new plant and machinery as opposed to 10 percent the previous year. The National Institute of Economic and Social Research is even more optimistic, forecasting a 9.5 percent growth, while the government boldly suggests fixed investment in manufacturing industry will rise by 10-15 percent in 1977.

A more detailed examination of the problems facing industry suggests that such projections could be fatally over-optimistic.

What Will Finance Industrial Investment?

The effect of the government's policy on debt financing through gilt sales all through the fall of 1976 has been to dry up any potential funds for industrial investment. While minimal efforts have been made recently by the government to bring down interest rates (but not so fast as to destroy the gilt market's willingness to finance official debt) and release limited funds into the banking system for industrial investment, figures released in the March 1977 Bank of England report indicate that the minimal increase in bank lending to industry has come mainly through taking up of already negotiated overdrafts.

Merely to return to the level of fixed investment attained in 1974 would require an increase of 22 percent in 1977 — and even this would not equal the peak 1970 level. While bank lending remains depressed, it is also unlikely that the levels of fixed investment required could be met by internally generated capital. It is ironic that while company profits, after subtracting stock appreciation and replacement costs, increased by 13 percent in the fourth quarter of 1976, such relatively high levels were partially due to the complete collapse of investment during 1975-76!

Even more indicative of the investment plans of industry is the orders on hand for new plant and machinery. New orders received by contractors for private industrial work have collapsed by 47 percent between 1974 and 1976. Even the most optimistic forecasts for increased investment do not approach this figure. While new domestic orders for machine tools appear to be increasing at a faster rate, the figures shown on the graph are in current, not constant pounds, and it is clear that if inflation were taken into account, the real level of machine tool orders would cohere more closely to the trend in contractors' orders.

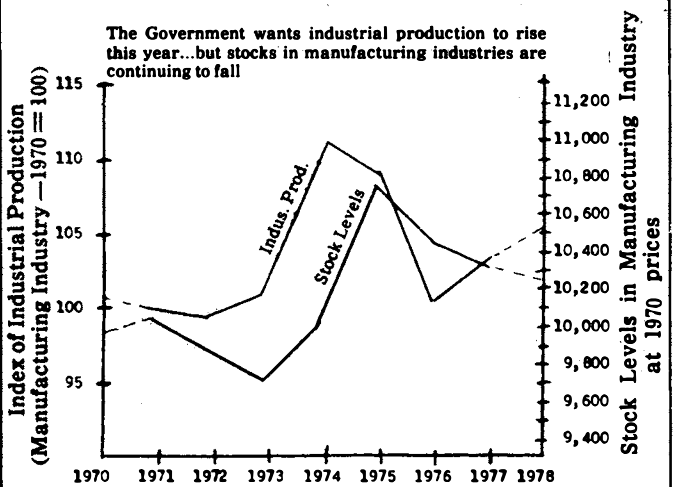
Who Can Afford to Produce, Anyway?

More frightening than the implications of the collapse in investment is the possibility that the recent trend of destocking in manufacturing industry, coupled with the increase in import costs to industry of basic materials and fuel, will mean, quite simply, that industry will be unable to afford to produce.

As indicated by the graphs comparing value and volume of imports and exports, while the depreciation of the pound has increased proportionately much faster as importers are forced to spend more pounds for the same amount of imported goods. Broken down further, the comparison between volume and unit value of imported basic materials and fuels makes the desperate situation of industry even clearer: while the actual volume of basic materials imports has risen by less than 10 percent since 1970, the unit value has tripled! With imported fuels, in volume terms, imports are below the 1970 level, but the unit value has increased almost eight times.

The impact of this increase in import costs to manufacturers is exacerbated by the fact that manufacturers'

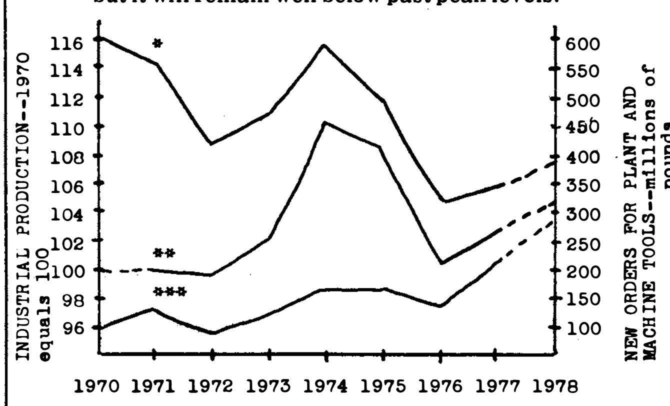
Industrial Production And Stock Levels In Manufacturing Industry



Source: Department of Trade and Industry

Manufacturing Output And Plant And Machinery Investment

Substantial increases in investment are forecast, but it will remain well below past peak levels.

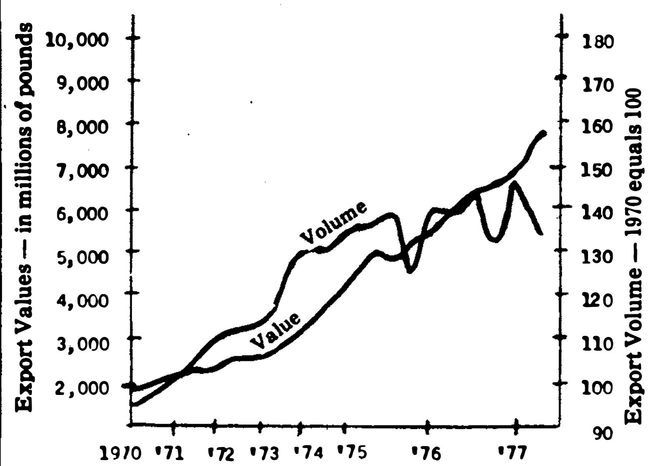


Source: Department of Trade and Industry

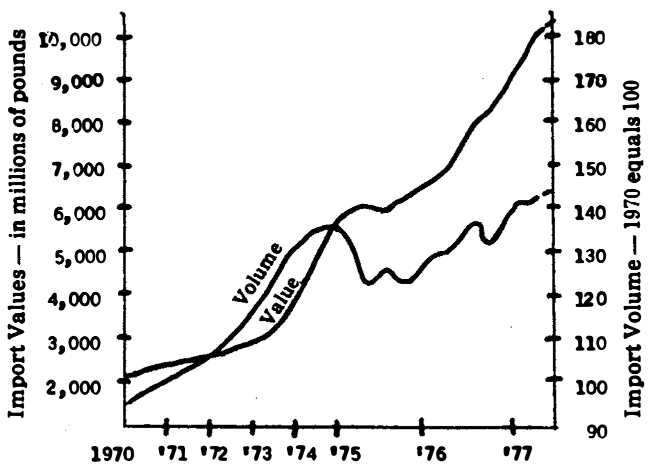
* New orders received by contractors for private industrial work, in 1970 prices.
** Industrial production, manufacturing industries.
*** New domestic orders received by machine tool manufacturers, current prices.

Balance Of Trade

While the collapse of the value of the pound sterling has increased the value of British exports abroad...



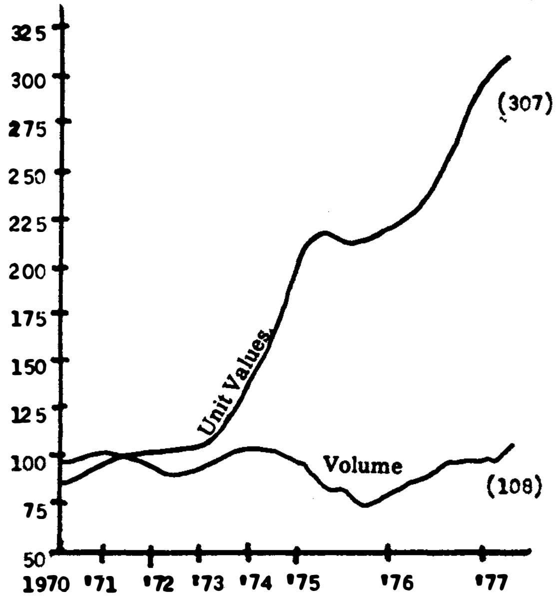
...it has simultaneously raised the cost of all British imports significantly above the volume of imported goods.



Source: National Institute Economic Review

Imports Of Basic Materials

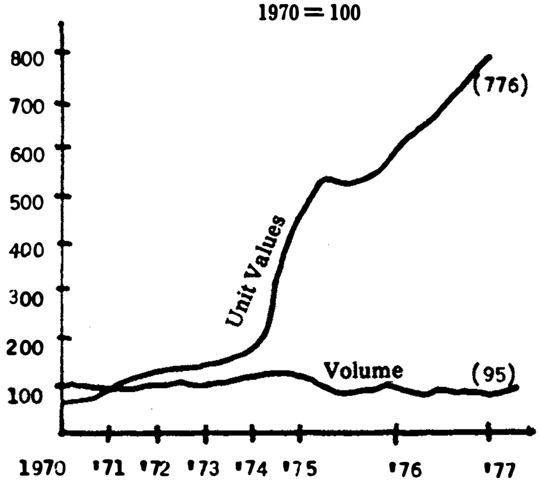
Volume and Unit Value Indices
1970 = 100



Source: National Institute Economic Review

Fuel Imports

Volume and Unit Value Indices
1970 = 100



Source: National Institute Economic Review

stocks are in no way near to recovering those of the peak production year of 1974. Squeezing manufacturers further is the fact that this obvious increase in their production costs has not been passed on to the retail level. As part of the social contract with the trade unions, the government has been consciously keeping retail price rises as low as possible — latest figures show a year-on-year increase of 16 percent, which largely reflects a 23 percent increase in food prices. Yet, wholesale buying prices increased by 4.75 percent in the fourth quarter of 1976, and reached a year-on-year level of 29 percent in February. As these wholesale prices work through to the retail level — as they must to a greater or lesser degree — the rise in inflation could seriously jeopardize the government's entire strategy with the trade unions, not to mention the undertakings on reducing inflation levels made to the IMF during loan negotiations last November.