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1994-1995

UNITED KINGDOM

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ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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BASIC STATISTICS OF THE UNITED KINGDOM

THE LAND

Area (1 000 sq. km)	241	Major cities (population in millions, 1992 mid-year estimates):	
Agricultural area (1 000 sq. km), 1992	185	Greater London	6.9
		Birmingham	1.0
		Glasgow	0.7
		Leeds	0.7
		Sheffield	0.5

THE PEOPLE

Population (30.6.1993), thousands	58 191	Total civilian employment, thousands, June 1994	25 150
Number of inhabitants per sq. km	241	<i>of which:</i>	
Net increase in population, 1983-93, annual average, thousands	165	Agriculture	565
Percentage change at annual rate, 1983-93	0.3	Industry (incl. construction)	6 583
		Other activities	18 003

THE GOVERNMENT

Public sector current expenditure on goods and services, 1994 (per cent of GDP)	22	Composition of House of Commons, April 1995 (number of seats):	
Public sector current receipts, 1994 (per cent of GDP)	36	Conservative	328
Net public debt, 31st March 1994 (ratio to GDP)	38	Labour	270
		Liberal	23
		Ulster Unionists	9
		Other	19
		Vacant seats	2
			651

FOREIGN TRADE

Exports of goods and services as a percentage of GDP, 1994	26	Imports of goods and services as a percentage of GDP, 1994	27
Main exports (percentage of total exports in 1994):		Main imports (percentage of total imports in 1994):	
Food, beverages and tobacco	7	Food, beverages and tobacco	10
Basic materials	2	Basic materials	4
Fuels	7	Fuels	4
Semi-manufactured goods	29	Semi-manufactured goods	26
Manufactured goods	54	Manufactured goods	55
Other	1	Other	1

THE CURRENCY

Monetary unit: Pound sterling		Currency unit per US\$, average of daily figures:	
		Year 1994	0.6533
		April 1995	0.6223

Note: An international comparison of certain basic statistics is given in an annex table.

This survey is based on the Secretariat's study prepared for the annual review of the United Kingdom by the Economic and Development Review Committee on 9th May 1995.

•

After revisions in the light of discussions during the review, final approval of the survey for publication was given by the Committee on 6th June 1995 .

•

The previous Survey of the United Kingdom was issued in July 1994.

Introduction

UK economic performance in 1994 was impressive. Real GDP growth was a solid 3.8 per cent, inflation was the lowest in twenty-seven years, unemployment fell significantly for a second year, the current account deficit was small and the budget deficit fell rapidly. The balanced nature of output growth and low inflation suggest not only that the UK economy is currently at a benign phase of the business cycle but also that it may have been made more flexible, competitive and less inflation-prone as a result of widespread structural reform launched in the 1980s.

Chapter I of this survey discusses salient features of the maturing UK economic recovery. It focuses on the divergent influences affecting household and business balance sheets and their implications for consumption, the housing market and investment. This is followed by a survey of labour market, costs and prices, balance of payments and supply-side developments.

The macroeconomic policy challenge is gradually to slow the growth of GDP to that of potential output, and to lock in low inflation. The policies in place, described in Chapter II, are aimed at avoiding the “boom and bust” patterns and asset price cycles which have marred many past economic cycles. Fiscal policy tightened significantly in 1994, at an early stage of the recovery. This eased domestic “crowding-out” and complemented the new monetary policy framework. In September 1994, base lending rates were raised for the first time in five years (and again in December and February), signalling the authorities’ commitment to low inflation.

In the past, economic upturns were constrained by emerging skill shortages, wage inflation and/or external constraints. To address these perceived weaknesses, the government introduced wide ranging reforms in the education and training systems, starting in the 1980s, targeted at raising low educational staying-on rates post-16 and weak intermediate vocational skills. These reforms have

begun to produce some improvements. A preliminary assessment of these reforms, as well as areas warranting further attention, is presented in Chapter III. Recent initiatives in structural reform, notably those aimed at lowering long-term unemployment are outlined in Chapter IV. Conclusions to the Survey are presented in Chapter V.

I. Recent economic developments

Overview

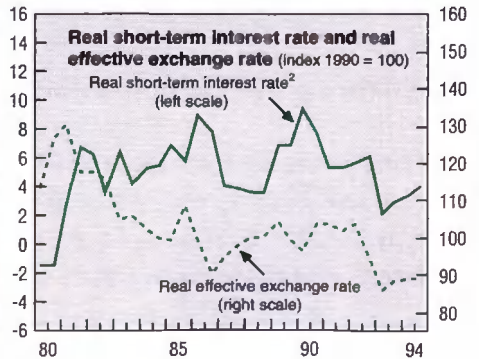
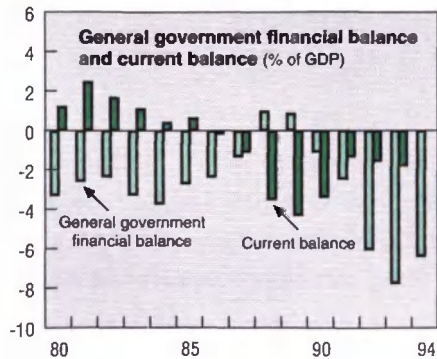
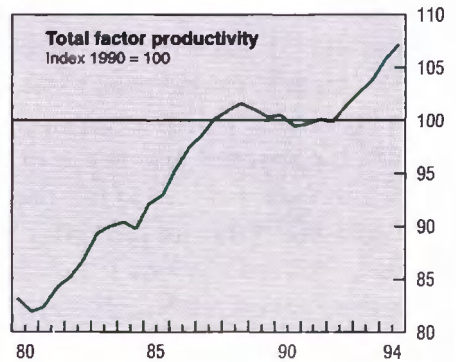
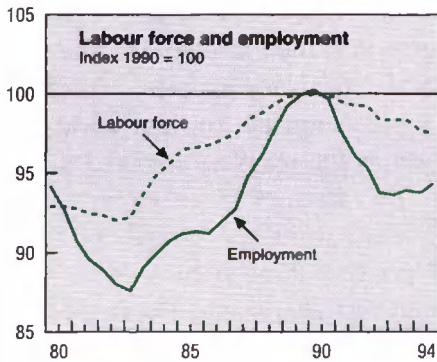
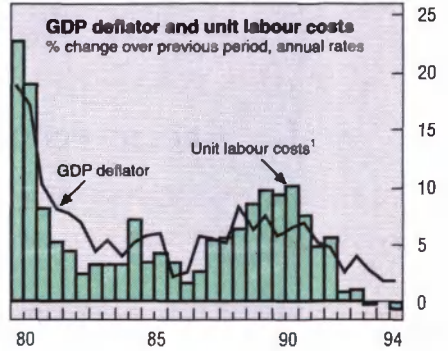
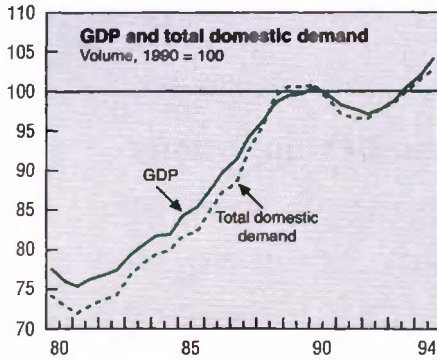
For 1994 as a whole, real GDP growth was 3.8 per cent, well above earlier consensus forecasts. Real GDP growth picked up to an annual rate of 4.0 per cent in the first half of 1994, but slowed in the last six months to 3.8 per cent (Diagram 1). The underlying sources of growth shifted through the year, from private consumption and public sector demand, to strong exports – reflecting a tightening in fiscal policy, a sustained real depreciation and buoyant world export markets. Employment also began to pick up as the recovery matured in 1994, with a shift from part-time to full-time jobs. By March 1995, unemployment was down 630 000 from its December 1992 peak, while the growth in average earnings remained subdued at less than 4 per cent through early 1995. Strong productivity gains have broadly stabilised unit costs, helping to absorb the impact of higher world commodity prices. By late 1994 there were signs that inflation, though remaining low, had passed its trough.

The maturing economic recovery

Data for the second half of 1994 indicate that GDP growth, albeit slowing, remained resilient and was still well above the growth of potential output (estimated by the OECD Secretariat at around 2½ per cent). Growth in private and public consumption remained subdued, offset by strong net exports and a modest pick up in non-residential investment.

At the turn of the year, growing signs of moderating growth emerged. Growth in retail sales, new car registrations and housing starts slowed markedly in the three months to March 1995, partly reflecting the impact of higher interest rates on the housing market and consumer confidence. The drop in unemploy-

Diagram 1. KEY ASPECTS OF ECONOMIC ACTIVITY



1. Total economy.
2. Three-month interbank rate adjusted by the GDP deflator.
Source: OECD, National Accounts and Main Economic Indicators.

ment also slowed from the very large falls seen at the end of 1994, and the number of new vacancies also fell back a little. Growth in manufacturing output, which had been strong in 1994, also moderated in early 1995. Export order books are, however, at record levels, capacity utilisation rates in manufacturing industry are above historical average, and business investment intentions rising. In the event, preliminary first quarter (output-based) GDP estimates indicate that economic growth remained sustained at an annual rate of over 3 per cent, largely reflecting a pick-up in services. Producer and retail price inflation picked up modestly in early 1995. But with business maintaining tight control over costs, and an early tightening in macroeconomic policies in place, the economy is on track for a “soft landing” beyond 1996 – characterised by continuing low inflation and a sustainable current account position.

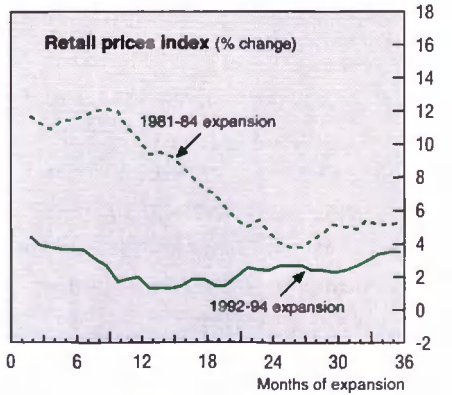
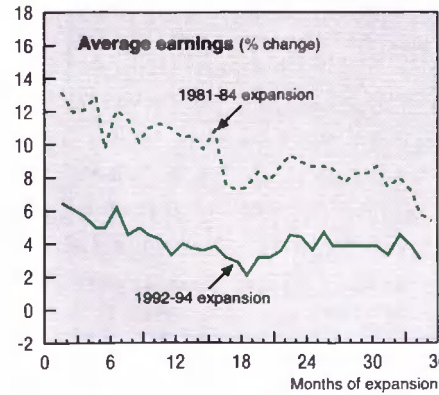
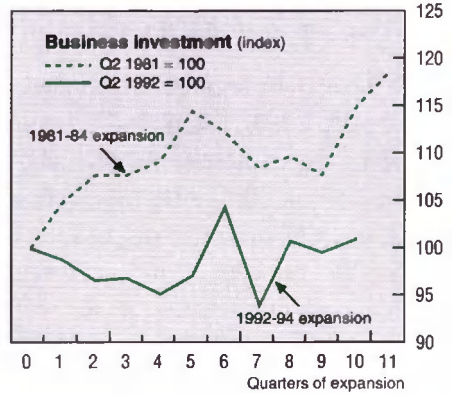
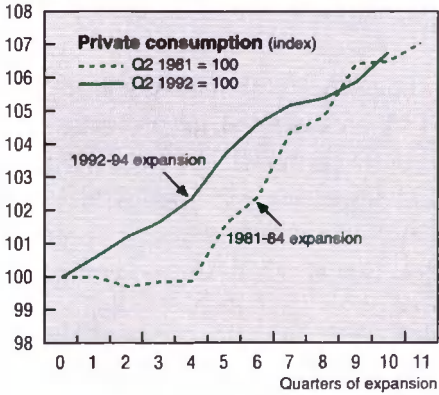
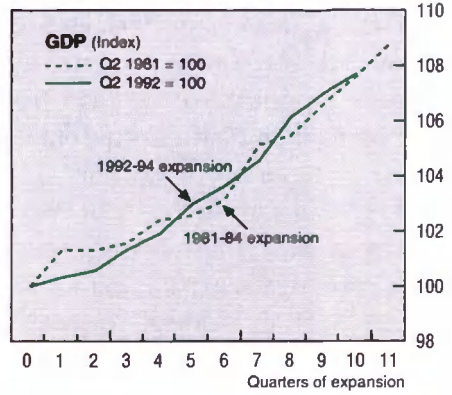
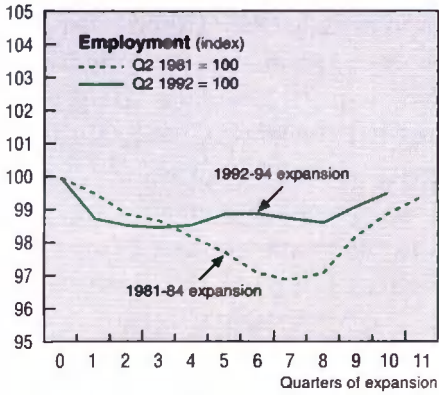
Rebalancing in domestic demand growth

Private consumption dominated the initial stages of recovery from early 1992 to late 1993 (Diagram 2),¹ supported by an easing in interest rates and a decline in record household financial savings, even though the housing market remained weak. In 1994, tax increases and lower tax exemptions had a big impact on real personal disposable income. As in 1993, private consumption grew by 2½ per cent, slowing through 1994. But as other demand components gathered pace, its relative share in the growth of total domestic demand fell compared with 1993 (Diagram 3). Real public consumption grew modestly in 1994, somewhat above budget forecasts, boosted by lower-than-expected inflation as spending is planned in cash terms.

A year ago, the likely reaction of consumers to the large tax hikes in April 1994 was uncertain. Debt levels remained high and house prices weak, but the improving financial position of households was expected to provide scope for absorbing these tax increases through lower savings (Diagram 4, bottom panel). In the event, the household savings rate may have dropped by almost 1½ points (Table 1). While “discretionary” spending on “big-ticket” consumer durables fell, spending on other consumption items proved resilient, due in part to keen retail price competition.

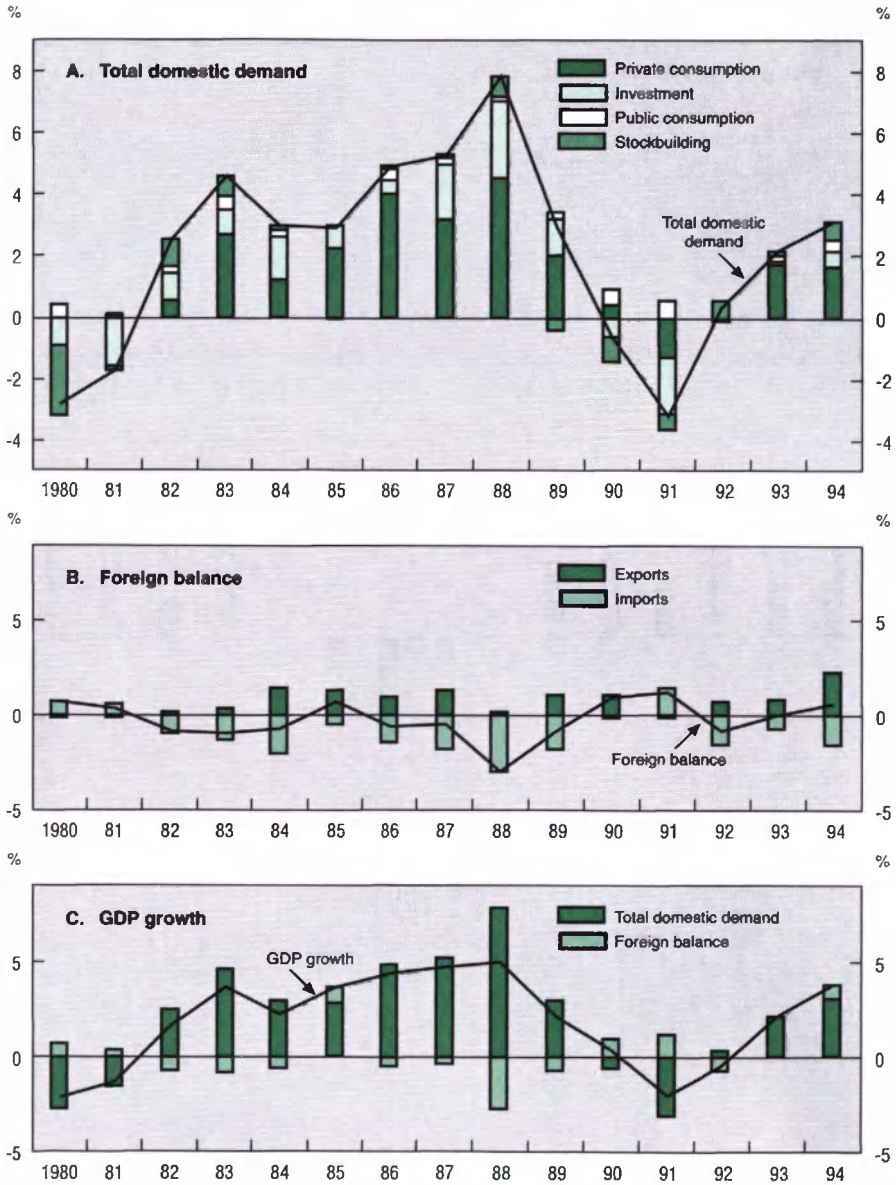
Assessing the future strength of consumption remains difficult. Some factors may weigh adversely. Thus, despite steadily declining unemployment, job insecurity is widespread in a deregulated labour market (see below), and higher

Diagram 2. THE CURRENT EXPANSION COMPARED



Source: Central Statistical Office, *Economic Trends*, and OECD, *Main Economic Indicators*.

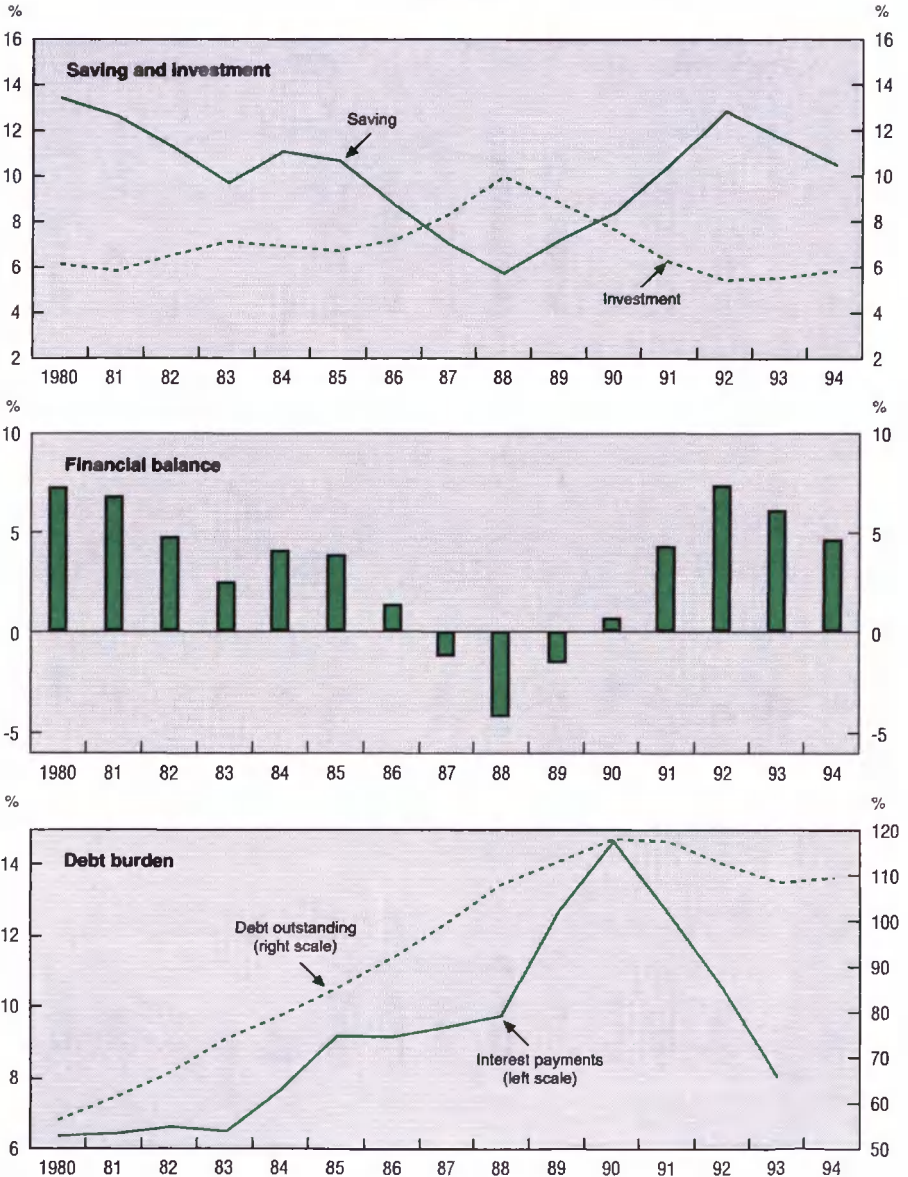
Diagram 3. CONTRIBUTIONS TO GDP GROWTH
As a percentage change of GDP in previous year



Source: Central Statistical Office.

Diagram 4. PERSONAL SECTOR DEVELOPMENTS

Per cent of disposable income



Source: Central Statistical Office, *Financial Statistics*.

Table 1. Demand and output
Annual percentage volume changes, 1990 prices, s.a.a.r.

	1988-91	1992	1993	1994	1994 ¹			
					Q1	Q2	Q3	Q4
Private consumption	0.5	0.0	2.7	2.6	2.2	0.7	1.8	3.4
Government consumption	2.2	0.0	1.0	1.6	1.8	1.9	0.9	1.3
Gross fixed investment	-2.5	-1.2	0.3	3.2	8.0	-5.0	-1.2	9.1
<i>of which:</i>								
Public ²	9.2	10.9	0.6	9.9	439.6	-67.0	32.9	4.0
Private residential	-11.5	2.9	4.3	6.4	8.9	5.3	-19.5	28.4
Private non-residential	-2.4	-5.1	-0.7	0.3	-34.7	32.1	-4.4	5.9
Final domestic demand	0.3	-0.2	1.9	2.5	3.1	-0.1	1.1	3.9
Stockbuilding ³	-0.6	0.5	0.3	0.5	1.0	1.0	-1.0	2.9
Total domestic demand	-0.3	0.3	2.2	3.0	4.1	0.9	0.1	6.8
Exports	2.9	3.1	3.3	8.9	7.3	11.1	14.4	10.9
Imports	0.7	6.2	2.8	5.9	10.5	-7.7	2.4	26.7
Foreign balance ³	0.5	-0.9	0.0	0.6	-1.0	5.2	3.0	-3.9
Statistical discrepancy ³	0.0	0.0	-0.1	0.1	0.4	0.1	0.0	0.0
GDP at market prices	0.2	-0.5	2.2	3.8	3.5	6.2	3.2	2.8
<i>Memorandum items</i>								
Output measure of GDP	0.3	-0.3	2.0	3.9	4.5	5.6	3.5	3.1
Manufacturing production	-0.4	-0.8	1.4	4.1	6.7	6.6	5.0	2.6
Employment ⁴	0.0	-2.5	-0.8	0.3	-1.5	0.0	2.4	1.8
Unemployment rate	7.0	9.9	10.2	9.2	9.7	9.4	9.1	8.6
Real personal disposable income	2.3	2.7	1.4	1.2	0.9	-1.2	3.9	2.2
Personal saving ratio	8.0	12.8	11.7	10.4	10.6	10.2	10.6	10.3

1. From previous period.

2. General government and public corporations. Figures are affected by the privatisation programme.

3. Changes as a percentage of GDP from previous period.

4. Yearly figures are averages of quarterly data for the months of March, June, September and December.

Source: Central Statistical Office, *Economic Trends*, and Department of Employment.

interest rates have lowered consumer confidence. Net personal wealth positions are also still below earlier peaks in relation to personal income.² The housing market remains sluggish with both turnover and house prices remaining subdued and home owners cautious in the presence of "negative housing equity".³ On the other hand, full-time employment is picking up, and the projected modest rise in earnings growth should boost household incomes. The effects of scheduled reduction in tax allowances and mortgage interest relief in 1995 should also be less than half as large as those in 1994. The personal sector financial surplus at about 5 per cent of GDP remains comfortable (*cf.* Diagram 4, middle panel).

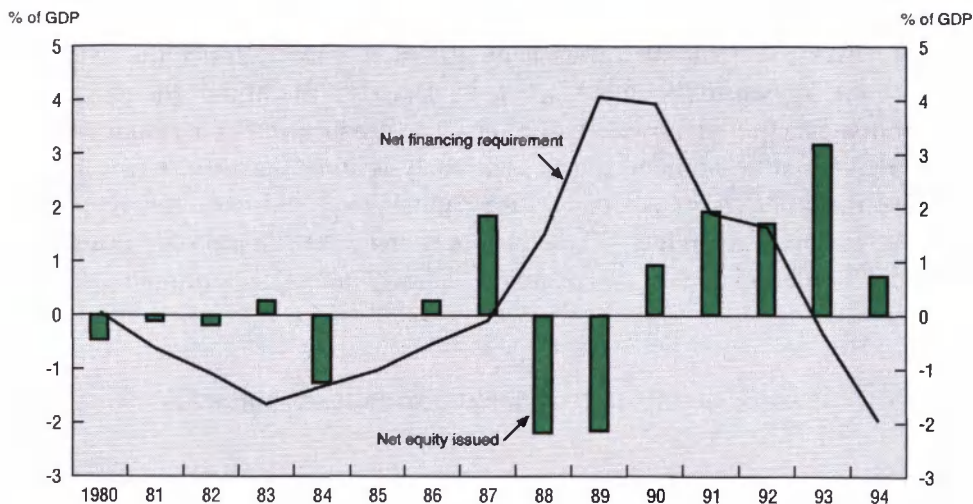
Investment has lagged, but is picking up

The share of total investment in GDP in this recovery has lagged that of the 1981-83 recovery, but trends are divergent between sectors. Investment in the oil and gas industries and public sector dwellings, which are largely autonomous to the general business cycle, have contracted during this expansion, in contrast to their brisk expansion in the early 1980s. Investment in manufacturing has been quite subdued in this expansion (although machinery and equipment investment began to pick up towards the end of 1994), while capital spending in the distribution sector has been relatively buoyant.

The non-financial corporations (NFCs) have been slow to invest in this expansion (*cf.* Diagram 2) partly because of the debts they took on in the late 1980s and the legacy of recession on their financial positions. But the process of balance-sheet adjustment should now have been completed. In previous upturns, UK companies increased their borrowing, tending to run balanced financial positions over the medium term. In this recovery, the NFCs made further net repayments of £7 billion from early 1993 through the third quarter of 1994, as well as issuing substantial new equity. This, together with only modest rises in capital expenditure, shifted NFCs' net financing requirements from near balance in 1993 to a surplus of around 2 per cent of GDP in 1994 (Diagram 5).

Business confidence, although weakening slightly in late 1994, remains relatively buoyant, reflecting expectations of steady export-led output growth. Capacity utilisation in manufacturing industry as reported by the CBI is above its long-run average. The early rise in interest rates could damp investment intentions, but investment – which is predominantly internally financed – is not being constrained by cash-flow. Business investment intentions appear cautious for this stage of the cycle. This may reflect long lags in adjusting internal “hurdle rates” to a low inflation environment and/or continuing uncertainty about the strength and durability of demand, – thereby favouring financial as opposed to physical investment.⁴ Hurdle rates may now be adjusting to a low inflation environment, albeit slowly. A cyclical recovery in investment and stockbuilding is expected to offset a further squeeze on the public sector in the next two years, though its timing and magnitude are uncertain. But higher investment, especially in sectors with high capacity utilisation rates, is needed to expand capacity and to sustain balanced economic expansion.

Diagram 5. **CORPORATE SECTOR FINANCING**



Source: Central Statistical Office, *Financial Statistics*.

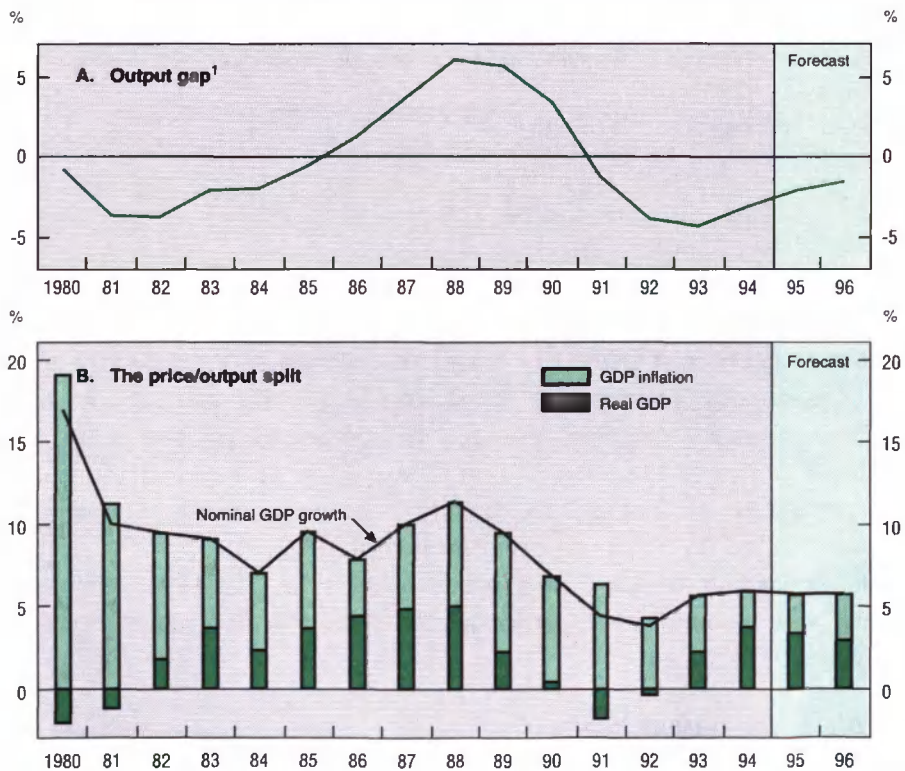
The share of UK industrial value added in GDP has declined steadily for decades. Since early 1992, however, value added in production industries⁵ has risen more rapidly than GDP. This has partly reflected strong growth in oil and gas output and a cyclical recovery in industrial output. But there also appears to have been an underlying improvement in the competitive position of the manufacturing sector, reflecting *inter alia* an influx of foreign direct investment, and an upgrading in technology and quality control standards. A competitive exchange rate and low inflation have consolidated these gains. In 1994, strong net exports further boosted output in production industries. For 1994, output of oil and gas was up almost 30 per cent, while manufacturing output grew by 4 per cent.

How big is the output gap?

Relatively high growth of industrial output and the slow response of investment has already raised capacity utilisation to above average rates in manufacturing industry, raising concerns of potential bottlenecks, higher inflation and/or a

deteriorating trade position. But there are no indications of shortages in the distribution and business services sectors, which account for the bulk of business output. Diverse sectoral rates of capacity utilisation make it difficult to judge the size of the aggregate “output gap” (see Diagram 6). Mid-cycle trends and production function estimates (based on trend productivity and labour supply) tend to give significant output gaps. Some analysts argue that these are overstated because of hysteresis of labour and the capital stock and that effective output gaps are currently negligible.⁶ These factors are relevant, but probably overstated. Physical bottlenecks may be relatively quickly alleviated through boosting

Diagram 6. **THE OUTPUT GAP AND NOMINAL GDP GROWTH**



1. As per cent of potential output.
Source : OECD.

investment, by more intensive use of existing capital or through imports. By contrast, reducing labour-market shortages by lowering the “natural rate of unemployment” no doubt requires targeted structural reform (see below).

The OECD Secretariat’s estimate of the output gap is based on a two factor Cobb-Douglas production function.⁷ Potential output is calculated as the level of output consistent with normal capacity utilisation and an estimated Non-accelerating Wage Inflation Rate of Unemployment (NAWRU).⁸ This results in an output gap of some 2 per cent of GDP in 1995. To the extent that the NAWRU has fallen (risen) further in recent years, the output gap would be proportionately larger (smaller).

Caution is necessary in deriving policy implications from output gap estimates. But they are a useful guide for capturing the interaction between microeconomic reform and potential output growth – the more so as many of the factors affecting the NAWRU and other supply factors are amenable to policy action.⁹

Has the labour market become more flexible?

A striking feature of this recovery has been the early drop in unemployment compared with previous cycles.¹⁰ Registered unemployment started falling in December 1992, accelerating in 1993 and particularly 1994, bringing registered unemployment down 630 000 by March 1995. Unemployment nonetheless remains high at 2.3 million or 8.4 per cent of the labour force. In contrast to most EU countries, UK unemployment peaked at a lower level in the recent recession than in the previous cycle in the 1980s. This may be an indication of improved flexibility, although it must be noted that the growth of the working age population has slowed substantially between the two cycles, and this could also partly explain the lower unemployment peak. A highly visible effect of labour market deregulation is the quicker adjustment of employment to changes in output.¹¹ Between 1966 and 1980, UK employment growth had a much lower variance than the growth of GDP and productivity, indicating that employment was basically unresponsive to cyclical changes in demand (Table 2). This pattern changed markedly from 1980 to 1994, when the variance of employment growth exceeded that of productivity. On these measures of flexibility, the United Kingdom now compares favourably with other G7 economies.

Table 2. Variations of output, employment and productivity

	Variance of annual growth-rates			Ratio of variances ¹	
	Output growth	Employment growth	Productivity growth	Output/employment	Productivity/employment
A. United Kingdom					
1966-1980	5.1	0.8	3.7	6.1	4.4
1980-1994	5.5	4.3	2.6	1.3	0.6
B. Cross-country comparison					
1976-94					
United States	4.0	2.1	0.9	1.9	0.4
Japan	2.6	0.3	1.8	9.2	6.4
West Germany ²	2.9	1.2	2.2	2.4	1.8
France	1.9	0.5	0.8	4.2	1.7
Italy	3.2	1.7	2.2	1.9	1.3
United Kingdom	4.5	3.6	2.2	1.3	0.6
Canada	6.0	3.4	1.8	1.8	0.5

1. A lower figure indicates greater variation in employment growth relative to output or productivity growth.

2. 1976-90.

Source: OECD.

Unemployment has come down faster and earlier in this recovery than in preceding ones, employment too seems to have responded somewhat quicker. There is, however, conflicting evidence on the growth of employment.¹² Employment as measured by the household Labour Force Survey (LFS) was up 90 000 between autumn 1994 and winter 1994/95 (Table 3). In 1993, part-time job creation did not offset full-time job losses. But between autumn 1994 and winter 1994/95, full time jobs accounted for 50 per cent of job creation, notably in services.¹³ This boosted the growth of total hours worked in the economy above that of total employment for the first time in the expansion.¹⁴ To date the labour market has shown few signs of emerging skill shortages.¹⁵

While the unemployment rate and the growth of employment are perhaps the most fundamental indicators by which to judge labour market functioning, the labour market is a complex many faceted phenomenon. The following section reviews UK experience using a number of other labour market indicators.

Long-term unemployment

As the expansion continues, short-term unemployment is expected to fall rapidly. But long-term unemployment remains a serious barrier to achieving

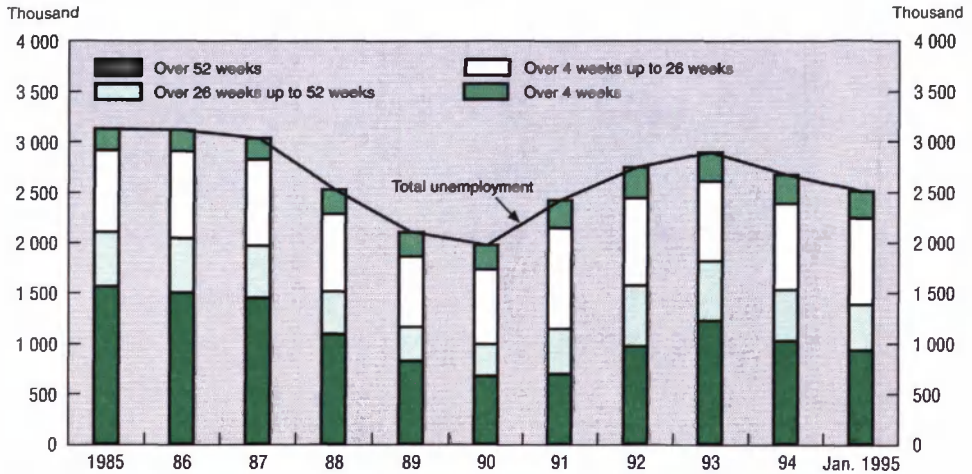
Table 3. **The labour market**

Percentage changes from previous period, s.a.a.r.

	1988-91	1992	1993	1994	1994			
					Q1	Q2	Q3	Q4
Working population ¹	0.1	-0.6	-0.4	-0.8	-1.4	-1.5	0.6	-0.5
Employment total	0.0	-2.3	-0.8	0.3	-0.7	-0.4	2.0	1.7
Employees	-0.2	-2.0	-0.7	0.0	-1.4	-0.2	2.4	0.8
<i>of which:</i>								
Manufacturing	-2.8	-5.0	-2.4	-0.7	-1.8	-0.9	-0.5	0.5
Government	-1.7	-4.4	-13.1	-9.5	-10.0	-7.7	-5.2	-2.7
Self employed	1.1	-4.3	-0.8	3.5	5.2	1.7	1.6	7.1
Employed ratio (level)	71.0	68.0	67.3	67.4	67.2	67.2	67.5	67.7
Unfilled vacancies ² (1 000)	189.9	117.1	127.9	158.0	141.5	149.3	162.4	178.7
Numbers unemployed-claimant count								
Adjusted (1 000)	2 006.9	2 765.0	2 900.6	2 619.4	2 749.5	2 665.2	2 595.0	2 467.8
Unemployment rate-claimant count								
Adjusted ³	7.0	9.7	10.3	9.3	9.8	9.5	9.2	8.8
Standardised ⁴	7.9	10.1	10.5	9.6	10.0	9.8	9.6	9.1
Youth (under 25)	12.5	15.4	17.3	15.5	15.9	15.3	16.5	14.3

1. All figures relate to the United Kingdom. The work force is the sum of employees in employment, the self-employed, H.M. Forces, the participants in work-related government training programmes and the unemployed. Quarterly data shown are for the months of March, June, September and December. Yearly figures are the averages of these four periods.
 2. Excluding Community Programme vacancies.
 3. The adjusted series has been restricted to claimants aged 18 and over to avoid breaks in the series due to new regulations in the entitlement of young people to claim unemployment-related benefits from 12th September 1988; it also takes account of past discontinuities to be consistent with current coverage. For a full description see *Employment Gazette*, December 1988.
 4. ILO/OECD definition, based on Labour Force Surveys.
- Source: Department of Employment, and OECD, *Main Economic Indicators*.

Diagram 7. **STRUCTURE OF UNEMPLOYMENT**



Note : Years are the averages of January, April, July and October figures.
 Source: Department of Employment, *Employment Gazette*.

“high employment”, with over 900 000 unemployed for over 52 weeks in January 1995. Even though long-term unemployment fell by over 150 000 during the year to January 1995, it still represented around 37 per cent of total claimant unemployment (compared with its previous 1987 peak of 43 per cent, see Diagram 7). Long-term unemployment places a high floor on the “natural rate”, which will only be effectively addressed by raising the labour market skills of the long-term unemployed and/or by increasing their attachment to the labour force. Experience with some pilot projects shows that some workers who had been unemployed for long periods, once on the job, are as productive as other workers (see Chapter IV).

Microeconomic flexibility

There is widespread evidence that greater microeconomic labour market flexibility has helped to clear labour markets more efficiently since the late 1980s. Greater flexibility has been reflected in the wide distribution of working hours, low strike activity, ease of hiring and firing, greater decentralisation of pay

fixing and working conditions, wider wage differentials according to the skill classifications and greater wage variation across regions.¹⁶ But greater microeconomic flexibility has yet to be significantly reflected in enhanced macroeconomic flexibility or in sustained low unemployment, although there are recent signs of change.¹⁷

Macroeconomic indicators of flexibility

Greater aggregate real wage flexibility can speed the return of actual unemployment to its “natural rate”. It may also influence the level of the “natural rate”, although lowering it is usually thought to require fundamental structural reform (see Chapter IV). Changes in flexibility can be formally tested for in the wage equations estimated by the OECD Secretariat (Annex I). Such estimates show that real wages have become more flexible in response to productivity and inflation shocks since the mid-1980s, but the changes are not statistically significant at conventional testing levels.¹⁸

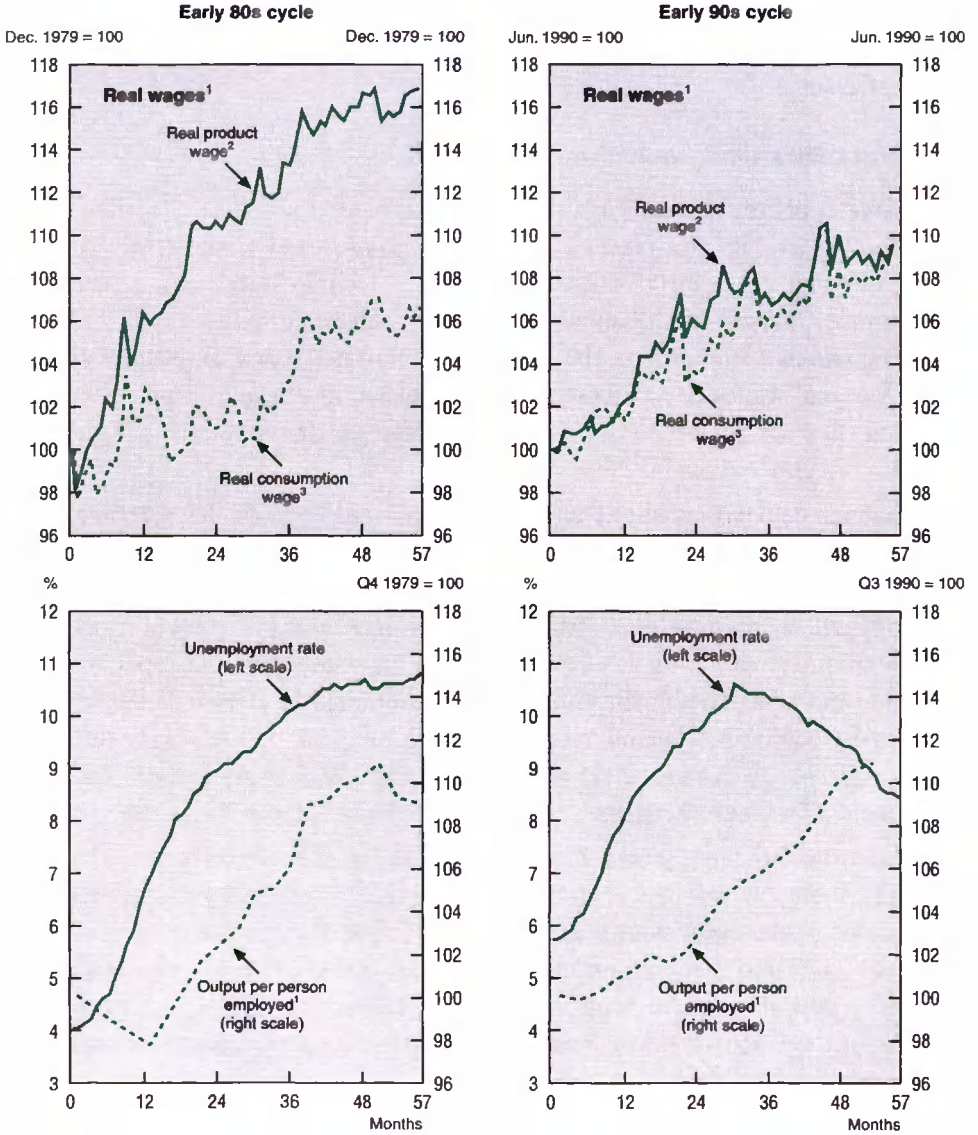
Labour demand equations also suggest that employment has become more responsive to real wages (Annex I). In the 1970s, there was apparently a small “perverse” positive relation between employment and real wages. In the 1980s, a significant negative relation between real wages and job growth emerged.¹⁹ This relation appears to have strengthened in this recovery. Real product wages started to moderate significantly in 1993 and continued in 1994 (see Diagram 8). Growth in output per person was strong and real unit labour costs fell from 1992 to 1994 (*cf.* Diagram 1, top right panel). Wage moderation has been instrumental in maintaining low inflation and pricing labour back into work.

Frictional unemployment has declined due to the narrower dispersion of unemployment rates across regions. In 1994, the differential between regional and national unemployment rates exceeded 2 percentage points in just two regions, compared with seven in 1984 (Diagram 9). Greater regional wage flexibility appears to have been important in this, as earnings growth has been weaker (on average) in those areas recording the greatest reductions in unemployment (Diagram 10).

Structural unemployment trends

Unemployment has been subject to wide cyclical swings since the 1980s, making it difficult to isolate the effects of reform on the NAWRU. Cyclical

Diagram 8. REAL WAGES IN TWO ECONOMIC CYCLES

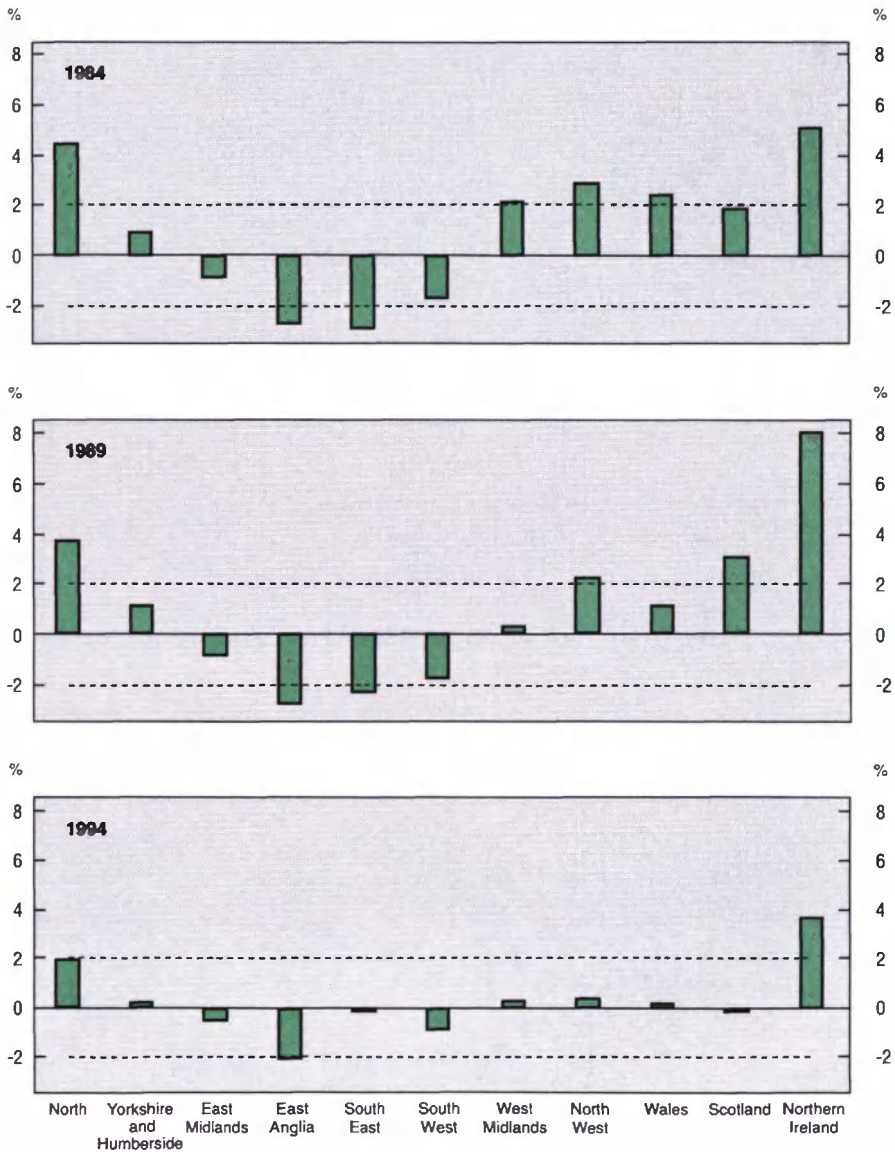


1. Whole economy.
2. Average earnings deflated by the producer price index excluding food.
3. Average earnings deflated by the retail prices index all items.

Source: Central Statistical Office, *Economic Trends*; Employment Department, *Employment Gazette*.

Diagram 9. DISPERSION OF REGIONAL UNEMPLOYMENT RATES¹

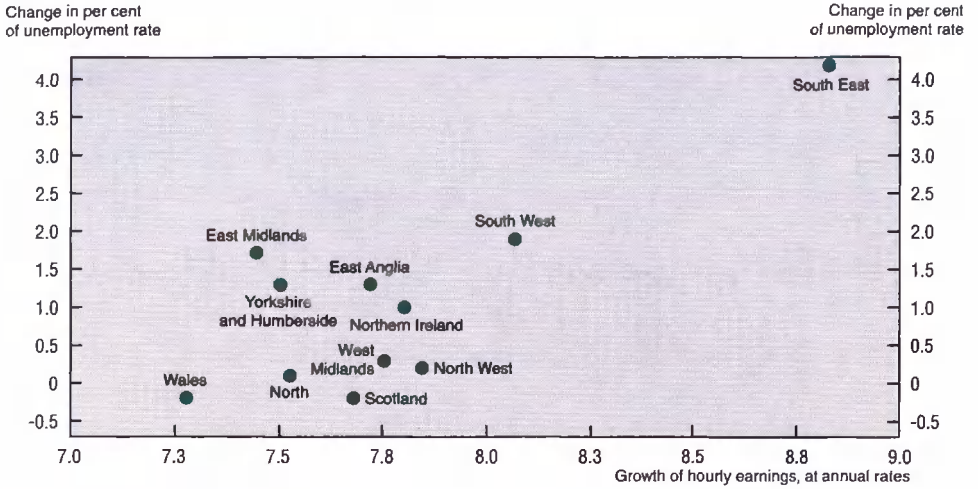
Difference between regional unemployment rates and UK rate



1. Averages of January, April, July and October figures.

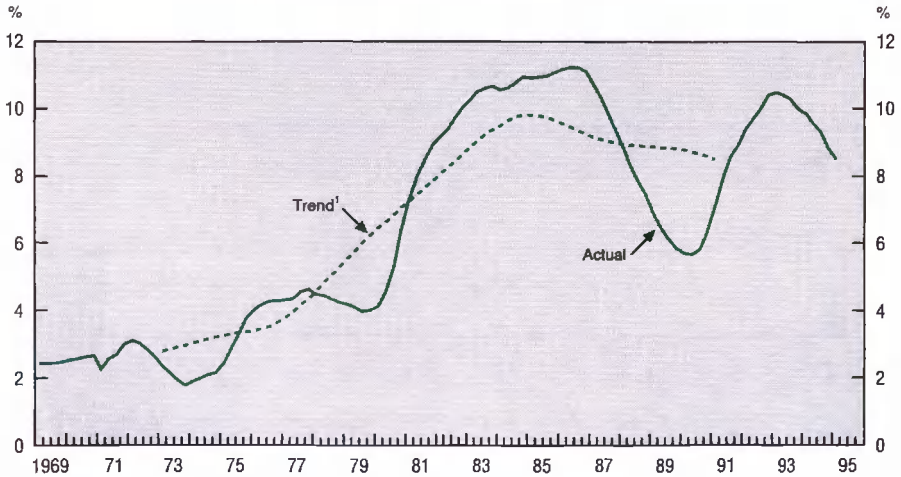
Source: Central Statistical Office, *Economic Trends*; Department of Employment, *Employment Gazette*.

Diagram 10. REGIONAL EARNINGS AND UNEMPLOYMENT RATES
1981-93



Source: Central Statistical Office, *Regional Trends and Economic Trends*.

Diagram 11. ACTUAL AND TREND UNEMPLOYMENT



1. Moving average over 8 years.

Source: Department of Employment, *Employment Gazette*.

variations can largely be eliminated by an eight-year moving average, which roughly proxies shifts in the “natural rate”.²⁰ This rose steadily through the 1970s, peaking at 9¾ per cent in early 1985, falling to 8½ per cent by the end of 1990 (Diagram 11). OECD Secretariat estimates now place the NAWRU at 7 to 7½ per cent. While the inexorable rise in trend unemployment has been recently reversed, the decline has been relatively modest to date.

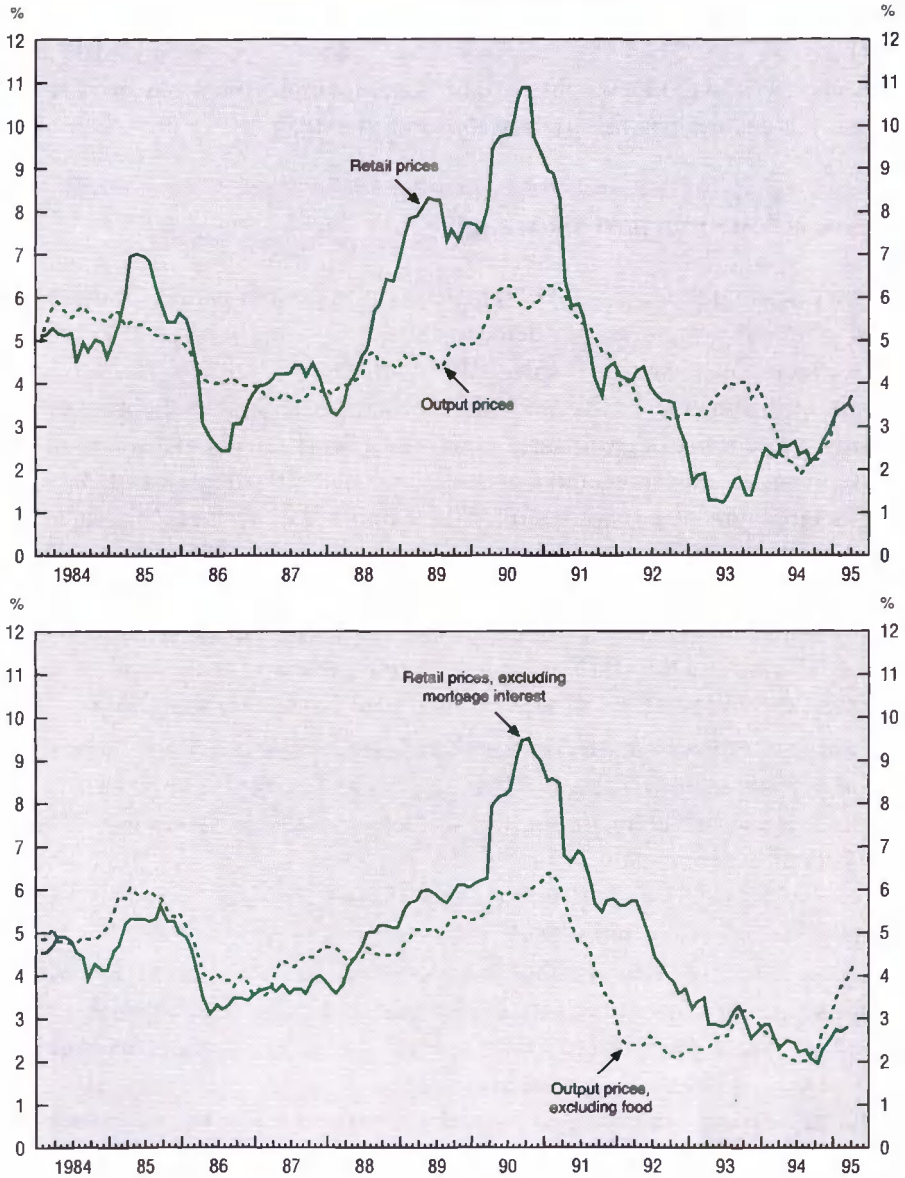
Inflation is low, but past its trough

The price/output split of GDP (*cf.* Diagram 6, bottom panel)²¹ indicates that the UK economy’s resiliency to demand shocks has improved. The Retail Price Index excluding mortgage payments (RPIX) fell through the two years following sterling’s exit from the Exchange Rate Mechanism (ERM) in September 1992 – passing a cyclical trough towards end 1994 (Diagram 12). This was in stark contrast to previous depreciation episodes, when rising domestic demand and falling unemployment promptly spilled over into inflation. Despite a rapid closing in the output gap, inflation remains moderate. In April 1995, the year-on-year increases in the “headline” RPI and in RPIX were 3.3 and 2.6 per cent respectively – up moderately from their 1994 lows, due in part to higher indirect taxes (Table 4). The rise in the RPIY, which is more representative of “core inflation” as it excludes indirect taxes as well as mortgage payments, was 2.1 per cent.

Last year’s Survey attributed the United Kingdom’s good post-depreciation inflation performance to a large output gap, more flexible wage behaviour, and keen product market competition. These factors continue to operate. The key factor behind attaining low inflation was the large output gap, following the tightening of monetary policy in the early 1990s. This gap is closing steadily, although pay and price setting may now be more sensitive to the level of the output gap. There are few signs of wage pressure to date. Underlying earnings growth for the whole economy was 3½ per cent in the year to March 1995, barely changed in over a year. Survey data suggest that wage settlements picked up slightly during 1994, but remained at around 3 per cent in early 1995. This nominal stability may indicate growing adaptation to a low inflation environment, with temporary blips in the RPI largely being ignored in pay setting.

Keen domestic and international product market competition continues to play a central role in reinforcing wage restraint and control over business costs.

Diagram 12. **INFLATION**
Year-on-year percentage changes



Source: Central Statistical Office, *Economic Trends*.

Table 4. Wages and prices
 Percentage changes from the same period a year earlier

	1989-91	1992	1993	1994	1994				1995
					Q1	Q2	Q3	Q4	Q1
Retail prices									
All items	7.7	3.7	1.6	2.5	2.4	2.6	2.3	2.6	3.4
Foods	6.8	3.1	2.6	1.8	1.5	1.7	1.5	2.4	3.5
Producer prices¹									
Material and fuel purchased	0.5	-0.4	4.4	2.6	-3.0	0.6	4.3	8.6	11.3
Output home sales	5.5	3.1	3.9	2.6	3.3	2.2	2.2	2.5	3.7
Import prices²	2.8	-0.5	7.8	2.4	-0.3	2.4	3.6	4.0	-
Earnings and wages									
Average earnings	8.9	6.1	3.5	4.0	4.2	4.0	3.8	3.9	-
Manufacturing	8.8	6.6	4.5	4.8	4.8	4.5	4.5	5.2	-
Public administration	9.3	5.9	4.6	3.6	3.8	2.9	3.5	4.0	-
Memorandum items									
National accounts deflators									
Private consumption	6.3	4.7	3.5	2.7	2.9	2.6	2.6	2.6	-
GDP at market prices	6.7	4.3	3.4	2.1	2.7	2.0	1.9	1.8	-
House prices ³	5.1	-3.9	-2.4	1.4	1.0	2.4	0.4	1.9	-
Unit wage costs⁴									
Total	8.9	4.1	0.3	0.1	1.0	-0.4	0.0	-0.1	-
Manufacturing	6.3	1.9	0.6	0.0	1.9	-0.2	-1.4	-0.5	-

1. Manufacturing.

2. Goods and services. Balance-of-payments definition.

3. All dwellings.

4. Wages and salaries per unit of output.

Source: Department of Employment and Central Statistical Office.

This has been most apparent at the retail level, where weak consumer demand and new entrants have promoted sharp price competition and a squeeze on margins. In many OECD countries, inflation is dominated by above-average service-sector price increases. This pattern is changing steadily in the United Kingdom. The insulated service sector is being increasingly exposed to competition (banking, insurance, telecommunications). Significantly tighter RPI capping formulae are being applied to the tariffs of the newly privatised public utilities (gas, water, electricity and telecommunications). Such factors are being reflected in a trend to lower service sector pay increases, rapid growth of outsourcing and expansion of small business.

Rapid improvement in the external accounts

Sterling's exit from the ERM in September 1992 had quite small effects on the United Kingdom's external accounts in 1993, as the 'J' curve effects typically associated with depreciation proved surprisingly absent. Indeed, the current account deficit narrowed in the course of 1993, moving into small surpluses in the third and fourth quarters of 1994 (Table 5). This shift reflected the benefits of a large "real" depreciation and possible improvements in aggregate supply conditions as well. The 1994 tightening of fiscal policy may also have provided scope for a shift in output towards net exports.

Part of the 1994 improvement in the trade accounts reflected strong oil exports, but non-oil visible trade performance was very strong by past standards. The response of trade volumes to shifts in trade prices typically takes several quarters. In this episode, export and import volumes appear to have responded more vigorously to sterling depreciation than in the past. Growth of exports of manufactures was around 10 per cent in volume in 1994 (Table 6). Part of this

Table 5. **The current account**¹
£ billion

	1990	1991	1992	1993	1994	1994			
						Q1	Q2	Q3	Q4
Exports	101.7	103.4	107.3	121.3	135.2	31.7	33.2	34.7	35.5
Imports	120.5	113.7	120.4	134.7	145.7	35.1	35.6	36.5	38.5
Trade balance	-18.8	-10.3	-13.1	-13.4	-10.5	-3.3	-2.4	-1.8	-2.9
Services, net	4.7	3.5	8.4	6.8	16.0	3.5	3.3	4.8	4.3
Investment income, net	1.0	-0.2	4.3	1.6	11.2	2.4	2.3	3.5	3.1
Non-factor services, net	3.7	3.7	4.1	5.2	4.8	1.1	1.0	1.4	1.2
Private transfers	-0.3	-0.3	-0.3	-0.3	-0.3	-0.1	-0.1	-0.1	-0.1
Official transfers	-4.6	-1.1	-4.8	-5.0	-5.4	-1.5	-1.6	-1.6	-0.7
Invisibles, net	-0.2	2.1	3.3	1.6	10.4	1.9	1.7	3.2	3.6
Current balance	-19.0	-8.2	-9.8	-11.8	-0.2	-1.4	-0.7	1.4	0.6
As per cent of GDP	-3.5	-1.4	-1.6	-1.9	0.0	-0.9	-0.5	0.8	0.4

1. OECD definitions.
Source: OECD.

Table 6. **Trade volumes and prices**

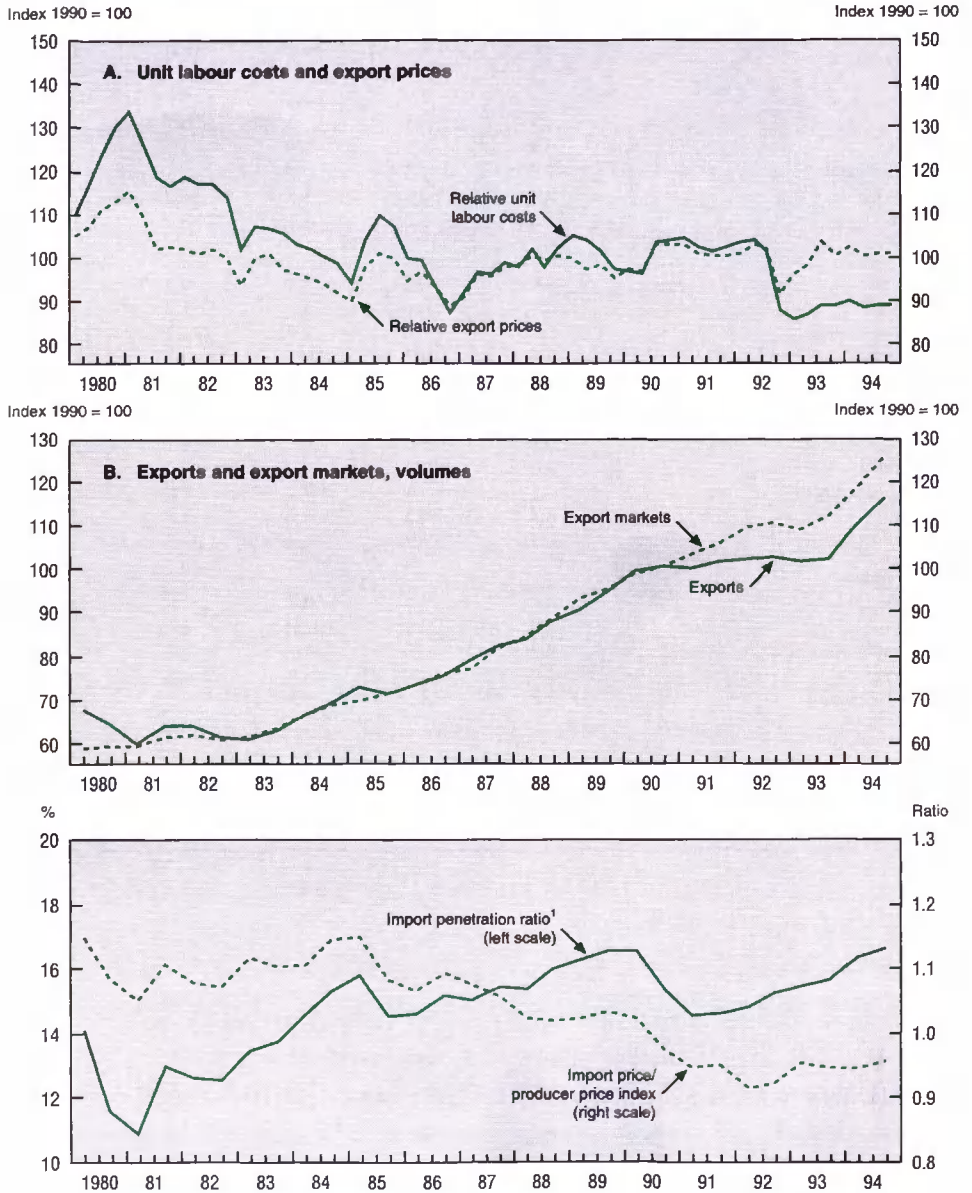
Percentage changes

	1990	1991	1992	1993	1994
Export volumes					
Total goods	6.5	0.5	2.1	-0.1	11.6
Food	0.8	4.2	7.9	-3.1	15.6
Manufactures	7.5	1.0	1.7	-0.5	10.8
Energy	8.7	0.3	3.8	14.2	17.5
Raw materials	-2.0	-9.2	-4.1	8.9	10.0
Export prices					
Total goods	3.9	0.5	1.3	9.6	0.6
Food	7.7	4.6	4.1	5.9	-3.9
Manufactures	2.6	1.2	1.4	10.7	2.0
Energy	18.5	-10.2	-6.1	3.8	-8.1
Raw materials	-2.2	-1.4	1.7	3.4	3.9
Import volumes					
Total goods	0.5	-5.4	6.4	0.1	6.6
Food	3.6	-0.2	7.0	-4.4	6.6
Manufactures	-0.5	-6.3	7.2	2.0	8.6
Energy	8.4	4.3	-1.7	-0.2	-14.7
Raw materials	-6.1	-9.5	6.3	2.3	2.8
Import prices					
Total goods	3.0	-0.4	-0.5	7.7	2.4
Food	4.0	0.4	1.8	6.7	-0.2
Manufactures	2.7	0.2	-0.1	7.3	2.8
Energy	13.4	-7.8	-6.4	4.8	-4.6
Raw materials	-0.1	-8.1	-5.5	4.2	9.8
Memorandum items					
Terms of trade					
Total goods	0.9	0.9	1.9	1.7	-1.8

Source: OECD.

performance can be attributed to the stronger than expected growth of world trade. But UK export market shares also increased, following three years of losses (Diagram 13, middle panel). By contrast, import volume growth relative to domestic demand was somewhat lower than predicted by historical relations. This may have reflected the relative slowing in the growth of UK domestic demand, while output picked up in its major trading partners, and/or on-going shifts in producer-client relations following sterling's improved cost competitiveness (Diagram 13, bottom panel).

Diagram 13. **INTERNATIONAL COMPETITIVENESS FOR MANUFACTURING**



1. Ratio of imports of manufactured goods to total domestic demand.
 Source: Central Statistical Office and OECD.

The terms of trade deteriorated slightly in 1994, partly reversing the surprising improvement in 1993, in large part reflecting the cyclical rebound in primary commodity prices from depressed levels. On the other hand, the United Kingdom's relative export prices (*cf.* Diagram 13, top panel) increased strongly in late 1993 while the relative unit labour cost position remained largely unchanged relative to its late 1992 levels. Strong underlying cost competitiveness apparently allowed a rebuilding in export profit margins.

A feature of current-account developments since the 1980s has been the sharp drop in the traditional surplus on invisibles. This trend decline was reversed in 1994, with net investment income rising to a record level. As a consequence, GNP increased slightly more than GDP at some 4.1 per cent. The improvement occurred despite the United Kingdom's broadly unchanged net external asset position (£36.6 billion at end-1994; UK direct investment abroad has, however, picked up significantly since 1992). There was a strong rise in UK overseas earnings related to direct investment in North America. At the same time, earnings of overseas companies fell (reflecting losses by subsidiaries of foreign financial companies). The large UK international banking sector continued to generate strong growth in commissions and fees. Compositional effects may be less important in 1995-96, as North American GDP growth moderates relative to that in Europe and Japan.

II. Macroeconomic policies and prospects

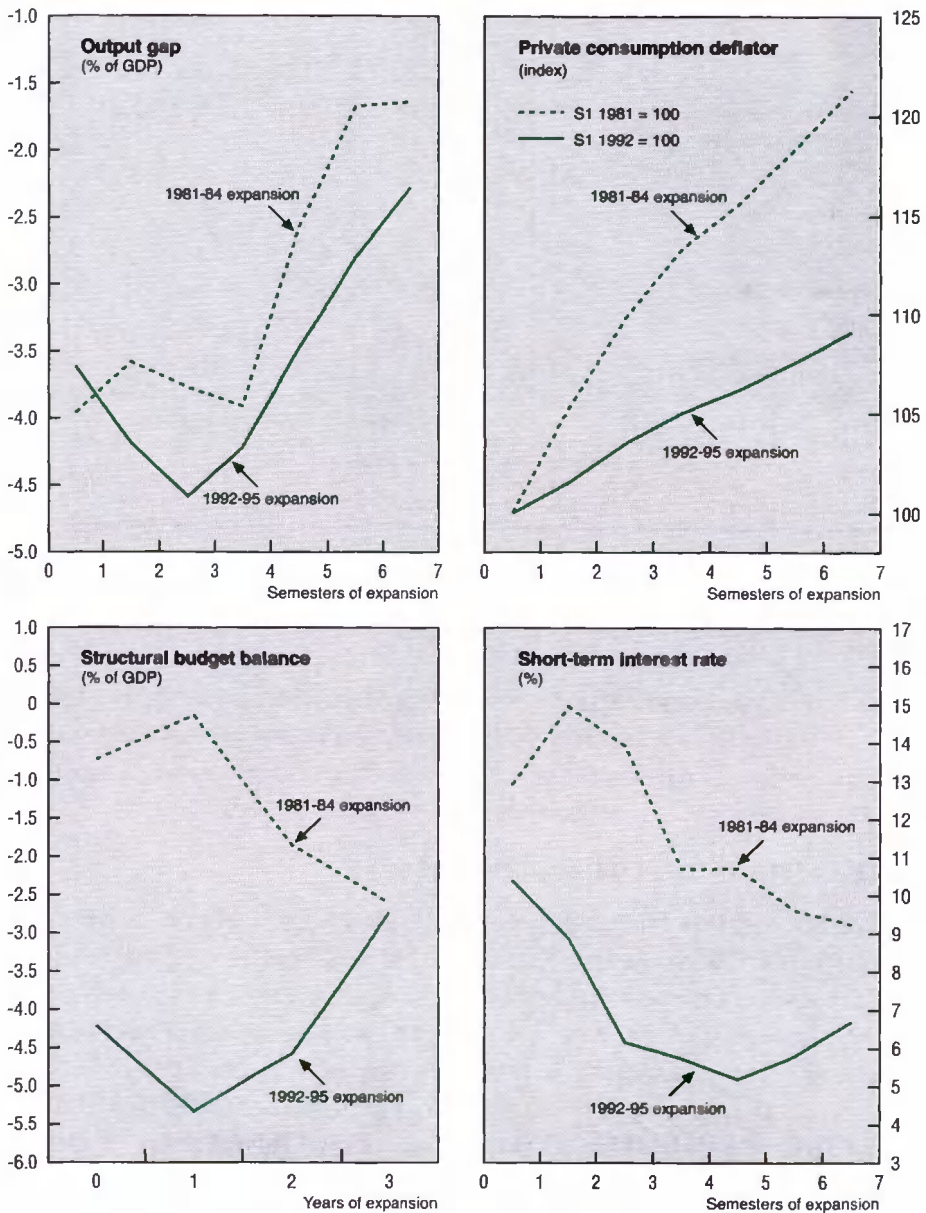
Economic growth began to pick up in early 1992, gathering momentum in the first half of 1994. Economic policy was tightened at a considerably earlier stage of the cycle than in past episodes (Diagram 14). The two 1993 budgets (especially the one in March which took the initial steps to tighten fiscal policy) were key in this process. Significant fiscal consolidation was programmed to take effect in FY 1994/95 and 1995/96²² – with the goal of reducing the Public Sector Borrowing Requirement (PSBR) from 7 per cent of GDP in FY 1993/94 to balance in the medium-term. By late 1994, with fiscal consolidation on track, the November 1994 budget took a neutral stance *vis-à-vis* the PSBR in 1995/96 and beyond. With demand and output growth proving stronger than expected in 1994, base lending rates were raised by 0.5 percentage points in September 1994, the first sustained increase since 1989. Base rates were raised by a further 0.5 percentage points in December and again in February 1995. The tightening of macroeconomic policies since spring 1994 was timely and prudent. Turbulence in international financial markets in early 1995 underlines the need to maintain prudent macroeconomic policies to strengthen credibility in the authorities' ability and determination to maintain low inflation and steady economic growth.

Fiscal policy

The medium-term financial strategy (MTFS)

Since the early 1980s, fiscal policy has been framed in terms of a medium-term financial strategy. The intermediate targets of the MTFS have evolved substantially over time, but its central theme remains to achieve sound medium-term public finances. The 1995/96 budget statement gave the government's

Diagram 14. STANCE OF ECONOMIC POLICY OVER TWO CYCLES



Source: Central Statistical Office, *Economic Trends*, and OECD, *Main Economic Indicators*.

Table 7. **Public sector finances in the medium-term**¹

£ billion

	Outturn	Forecast		Projection ²			
	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/2000
General government expenditure	277.5	288.9	301.8	312	323	332	341
General government receipts	230.8	252.6	278.7	297	315	332	349
General government borrowing requirement	46.7	36.3	23.1	15	7	0	-8
PCMOB ³	-1.3	-2.0	-1.6	-2	-2	-1	-1
PSBR	45.4	34.3	21.5	13	5	-1	-9
PSBR (per cent of GDP)	7	5	3	1¾	¾	0	-1
<i>Memorandum items</i>							
Real GDP growth (per cent)	2¾	4	3	2¾	2¾	2¾	2¾
Inflation (GDP deflator) (per cent)	3	2	3¼	2½	2¼	2	2

1. Constituent items may not sum to totals because of rounding.

2. Projections are rounded to the nearest £1 billion from 1996/97 onwards.

3. Public corporations' market and overseas borrowing.

Source: *Financial Statement and Budget Report 1995/96*, revised tables.

objective as bringing the PSBR back to balance over the medium-term (Table 7). The United Kingdom (unlike many EU countries) already satisfies the Maastricht treaty convergence criterion for government debt, and is projected to satisfy that for public borrowing as a proportion of GDP in FY 1996/97.

The PSBR in 1993/94 and 1994/95

The FY 1993/94 budget projected a PSBR of £50.1 billion (8 per cent of GDP). The OECD Secretariat estimates that this massive deficit reflected a significant cyclical element, as well as a large structural deficit of some 5 per cent of GDP, although such estimates are subject to uncertainty and should be treated with caution. The structural deficit depends *inter alia* on estimates of the actual output gap, and these may vary sharply.²³ In the event, the actual 1993/94 outturn was a PSBR of £45.4 billion (7 per cent of GDP) (Table 8). This undershoot reflected the fact that revenue was £2½ billion above forecast and spending £1¾ billion below, with the contingency reserve of £4 billion not being fully spent.

Table 8. Budgetary developments

£ billion

	1992/93		1993/94		1994/95	1995/96
	Budget forecast	Outturn	Budget forecast	Outturn	Budget forecast	
					November 1994	
Receipts	237.4	225.1	232.0	232.2	256.6	282.1
<i>of which:</i>						
Taxes on income and oil royalties	76.7	72.7	73.9	74.5	86.0	97.9
Taxes on expenditure	93.0	88.0	91.7	92.5	99.1	108.2
Social security contributions	39.1	37.3	39.3	39.5	42.8	44.8
Gross trading surplus	3.7	3.0	3.6	3.4	6.0	6.2
Community charge/Council tax	8.3	8.1	8.0	8.0	8.5	9.1
Expenditure	268.3	269.1	286.5	284.1	284.1	296.0
<i>of which:</i>						
Final consumption	130.9	133.5	140.0	140.2	145.6	148.3
Subsidies	6.1	6.8	7.6	7.0	7.9	8.1
Current grants to personal sector	81.0	82.9	89.5	90.4	92.5	95.2
Debt interest	18.4	17.9	19.8	19.7	22.6	25.1
Gross domestic fixed capital formation	18.2	17.8	17.9	16.8	17.8	16.2
Capital grants to private sector	4.1	5.4	5.7	5.3	5.3	5.8
Unallocated reserve	4.0	–	–	–	–	3.0
Financial deficit	30.9	44.0	54.5	51.0	40.2	25.6
Financial transactions	–2.8	–7.8	–4.8	–5.6	–6.0	–3.7
<i>of which: Transactions in company securities¹</i>	–8.0	–8.2	–5.5	–5.5	–6.3	–3.0
Public sector borrowing requirement	28.1	36.2	49.8	45.4	34.3	21.5
<i>of which:</i>						
Central government		36.3		48.9		
Local government		1.4		–2.1		
Public corporation		–1.5		–1.3		

1. Including privatisation proceeds.

Source: Central Statistical Office, *Financial Statistics, Financial Statement and Budget Report 1992/93, 1993/94 and 1994/95*, revised tables.

The FY 1994/95 outturn was a PSBR of £35.6 billion (5.3 per cent of GDP). However, unlike the previous fiscal year, this improvement was largely due to discretionary policy measures. Tax and national insurance measures are estimated to have raised revenue by an estimated £6.3 billion, while the Control Total (government spending less spending on cyclical social security and debt interest payments) fell by an estimated 1 per cent of GDP in FY 1994/95.

The 1995/96 budget

The November 1994 budget statement projected continuing falls in the PSBR, broadly in line with those in the November 1993 budget (*cf.* Table 7). The PSBR is projected to decline to 3 per cent of GDP in FY 1995/96, and to achieve balance in FY 1998/99. The 1994 budget had limited effects on projected revenue, as the 1993 budget had already programmed measures which were expected to raise £6½ billion (0.9 per cent of GDP) in FY 1995/96.²⁴ However, the previously scheduled increase in the VAT rate on domestic fuel from 8 to 17 per cent was rejected by Parliament. These revenue losses were offset by higher excises on alcohol, fuel and tobacco.²⁵

The latest budget's spending plans envisage real cuts in control total spending of 0.8 per cent in FY 1995/96. In nominal terms, control total spending is projected to rise by £6 billion, and total general government expenditure (excluding privatisation proceeds) by £10 billion. This will represent a bare 0.1 per cent real increase and should reduce the ratio of general government spending to GDP from 43½ per cent to 42½ per cent between FY 1994/95 and 1995/96. Further constraint on government spending is planned. Real growth in the control total is programmed at 0.5 per cent in FY 1996/97 and 1 per cent in FY 1997/98. By FY 1997/98 the share of general government spending is projected at 41 per cent of GDP.

The stance of fiscal policy

The large swings in the PSBR in recent years reflect both cyclical and structural developments, generally going in the same direction. While cyclical factors contributed to a marked deterioration in the PSBR from 1989 until mid-1993, and to their improvement since then, OECD Secretariat estimates suggest that these were reinforced by changes in structural budget balances. Cyclically-adjusted general government borrowing rose from 2.2 per cent of GDP in 1991 to 5.6 per cent in 1993, but is projected to decline quickly to 1.7 per cent in 1996 (Table 9). Approximately 60 per cent of this projected reduction is attributed to higher revenue and the rest to a decline in the share of non-cyclical spending as a proportion of GDP.

The ratio of gross government debt to GDP increased from 35 to 48 per cent in 1994 (*cf.* Table 9). This ratio is projected to peak at 49 per cent in 1995 and to fall thereafter. The ratio for net debt to GDP is some 6 percentage points lower,

Table 9. **Government borrowing and debt**
As per cent of GDP

	1990	1991	1992	1993	1994	1995	1996
General government							
Balance							
Financial	-1.2	-2.6	-6.1	-7.9	-6.7	-4.2	-2.6
Structural	-3.1	-2.2	-4.2	-5.6	-4.9	-3.0	-1.7
Primary	1.2	-0.5	-4.1	-5.7	-4.0	-1.7	-0.1
Debt							
Gross ¹	35.2	34.3	35.4	41.5	47.2	49.0	48.4

1. Debt at end-March/GDP centred on end-March.

Source: Bank of England and OECD estimates.

reflecting earnings on government financial assets. The United Kingdom is projected to remain comfortably below the Maastricht Treaty convergence criterion for government debt.

The fiscal consolidation enacted in 1994 and 1995 has put public finances back onto a sustainable medium-term path. The structural deficit has been substantially reduced, and the debt-to-GDP ratio should peak in 1995. At this stage in the business cycle, it is desirable that fiscal policy should continue to be directed at the medium-term objective of a balanced budget, and would have the effect of raising the contribution of government to national saving. Consequently, any changes in tax and spending plans should not increase the fiscal deficits projected in the 1995/96 budget statement.

Monetary and exchange rate developments

The new monetary policy framework

Since September 1992, the UK monetary authorities have faced the challenge of filling the policy void left by sterling's suspension from the ERM; containing the inflationary effects of depreciation; and establishing credibility in their commitment to attaining and locking in low inflation. The "new monetary policy framework" responded to this challenge. Its key ingredients are:

- a specific low inflation objective;²⁶

- publication of an independent quarterly assessment of inflation prospects by the Bank of England;
- a monthly review of inflation prospects by the Chancellor of the Exchequer and the Governor of the Bank of England, with publication of the minutes of their meeting two weeks after the subsequent meeting;
- once the Chancellor has decided to change interest rates, the Bank has discretion over the precise timing of implementing the change;
- a panel of independent economists which provides an assessment of the economic outlook and policy recommendations to the Treasury twice a year, with subsequent publication of their report.

A crucial (but frequently misunderstood) feature of the framework is its forward-looking orientation. This recognises that it takes one to two years for changes in monetary policy to have a significant impact on economic activity and inflation prospects. Consequently, policy is set not on the basis of current inflation outcomes, but on inflation prospects two years hence.

Assessing inflation prospects over a two-year horizon requires a blend of statistical analysis and judgement. The authorities monitor a wide array of financial indicators, including interest rates, money supply, credit, sterling's effective rate, and asset prices (including house prices) – as well as forming a judgement on the real economy and the output gap. But such a wide array of data can lead to conflicting indications, underlining the need for judgement in forming a policy assessment (Table 10).

Transparency plays a central role in the new framework. The low inflation objective gives a clear nominal anchor for inflation expectations. The publication of the minutes of the monthly monetary policy meeting reveals what indicators are used to form the authorities' assessment of the economy, and the reasons behind policy decisions to change or not change interest rates. It also increases the accountability of the Central Bank by making public the Governor's policy recommendations.

Interest rate developments

The new policy framework has helped to build credibility. However, long-term interest rates in the United Kingdom remain above those in Germany and the United States, suggesting that financial markets still perceive the

Table 10. **Inflation report projections and base rate changes**

Inflation report	Central inflation projection ¹	Subsequent base rate changes
1994: February May August November	Just over 3 per cent 3 to 3½ per cent 3 to 3½ per cent ² Around 2½ per cent	8 February: reduced from 5½ to 5¼ per cent Unchanged 12 September: raised to 5¾ per cent 7 December: raised to 6¼ per cent 2 February: raised to 6¾ per cent
1995: February May	Around 2½ per cent Around 3 per cent	Unchanged Unchanged (as of 30 June)

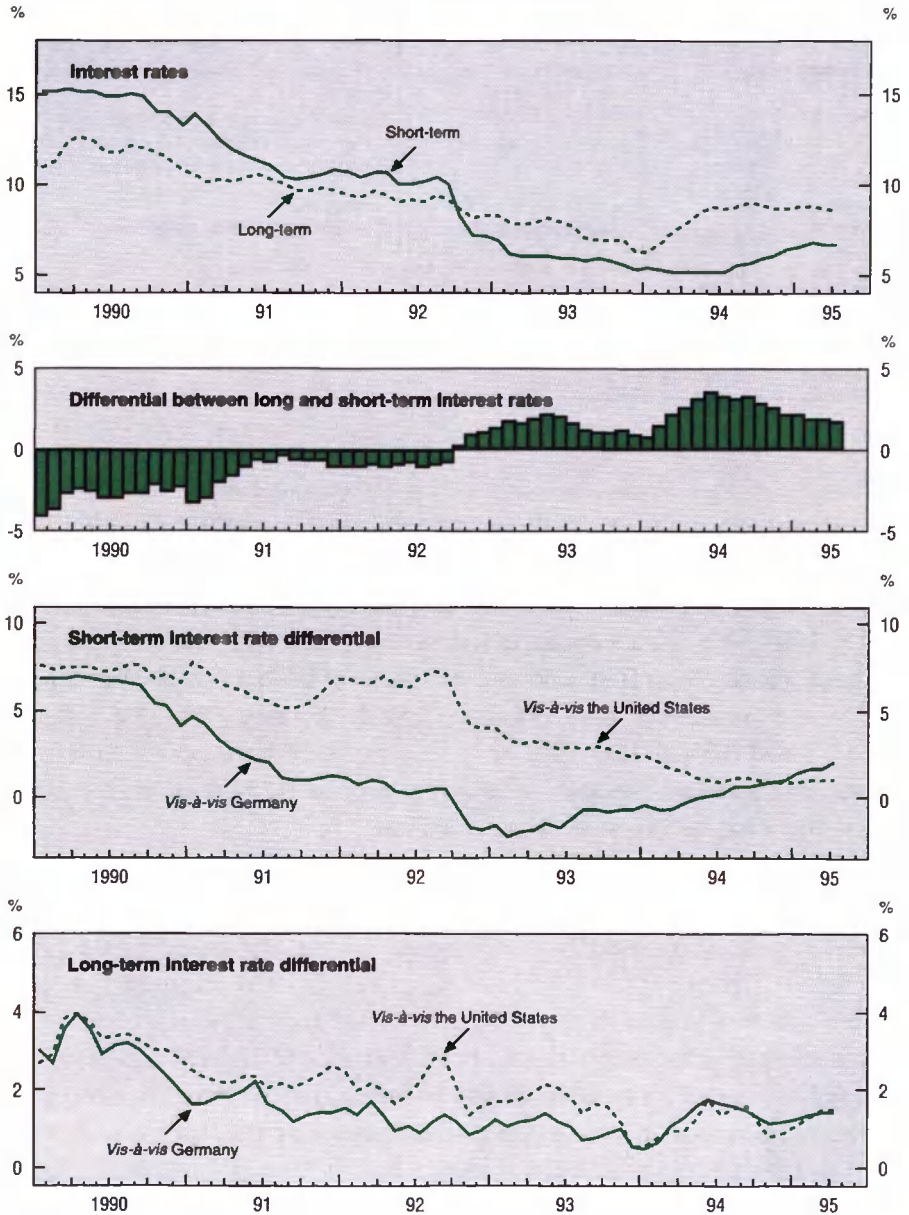
1. Projections are for inflation as measured by RPIX deflator, with projection horizon two years from date of the inflation report. It should be noted that each projection is accompanied by a warning that the central projection is only the most likely outcome of a wide range of possible outcomes.
2. Not stated explicitly. Inferred from statement "the outlook for two years hence is virtually unchanged (from the May Report)".

Source: Bank of England, *Inflation Report*.

United Kingdom as a greater inflation risk. Nonetheless, while long-term interest rates are a relevant measure of credibility, they are not an unambiguous guide. Major bond markets world-wide were affected by turbulence and falling bond prices in 1994. The UK bond market was severely affected, with ten-year government bond yields rising from a low of 6¼ per cent in January 1994 to a peak of 9 per cent in September 1994 (Diagram 15). In January 1994, the differential against US and German long-term rates was around 50 basis points, quite narrow by historical standards, but it widened to around 125 basis points between January and June, as investors re-assessed risk.

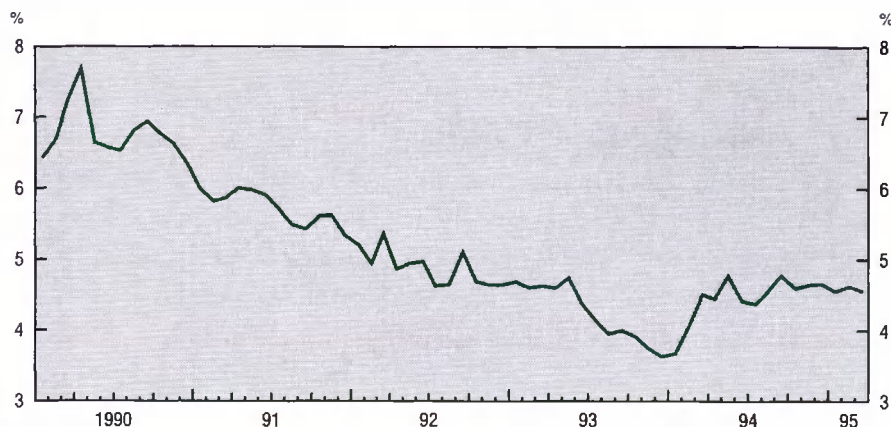
Last year's Survey suggested that the framework's "acid test" would be how rapidly the monetary authorities responded to signs of latent inflation pressure. So far, this test has been passed. Base rates were first raised by 0.5 percentage points in September 1994, when contemporaneous indicators of "underlying inflation" were falling or flat (*cf.* Chapter I). This forward-looking rate increase raised sterling and long-term bond prices, and the differential against German bonds fell by around 25 to 30 basis points during the last three months of 1994. Subsequent increases in base rates in December and February also helped to lower UK long-term interest rates to around 8.3 per cent in early May 1995. But long-term interest rate differentials *vis-à-vis* the United States and Germany have changed little since December – possibly because the last two increases in base rates were anticipated by financial markets.

Diagram 15. **INTEREST RATES DEVELOPMENTS**



Source: Central Statistical Office, *Economic Trends*, and OECD, *Financial Statistics*.

Diagram 16. **INFLATION EXPECTATIONS**¹
Year-on-year percentage changes



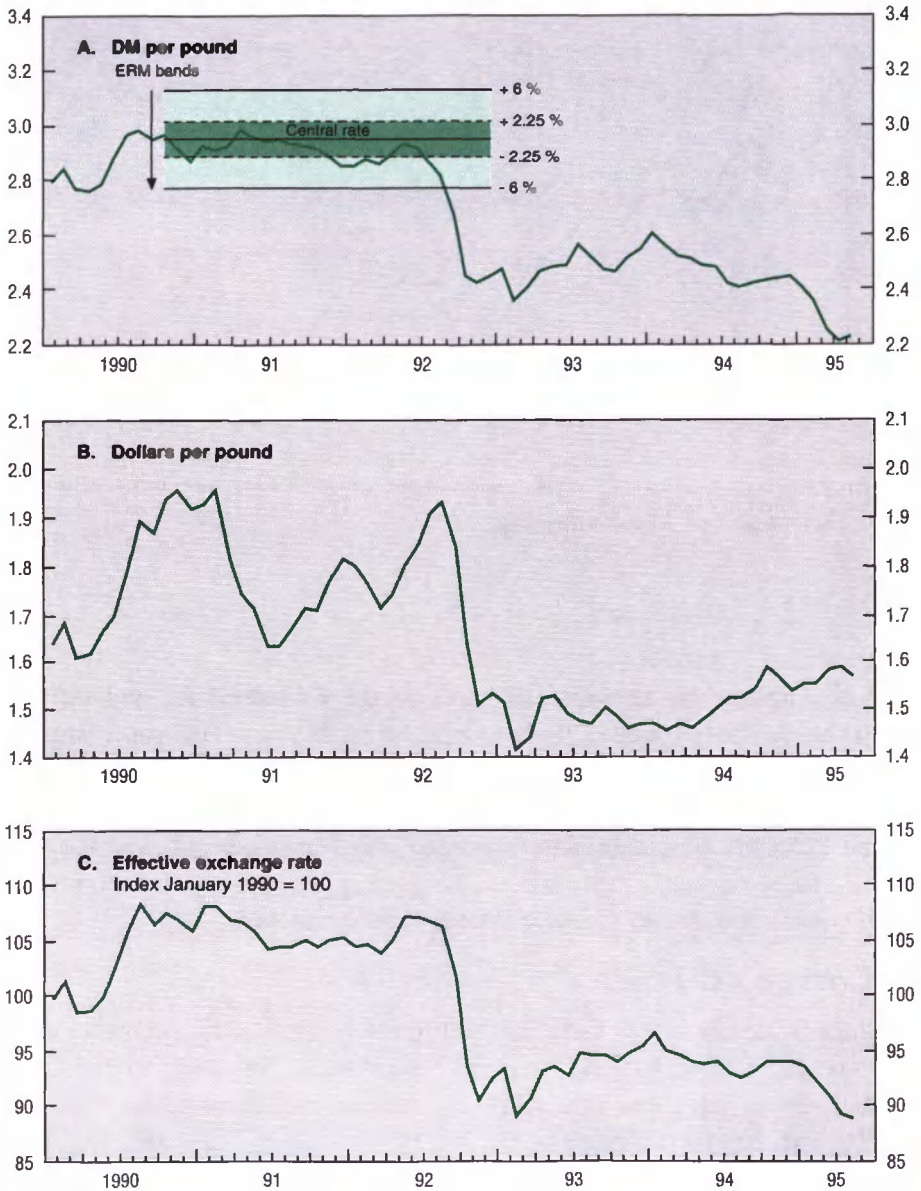
1. Measured by the difference between the real gross redemption yield on Treasury index-linked long-term bonds and the gross yield on Treasury bonds.
Source: Central Statistical Office, *Financial Statistics*.

Persisting interest rate spreads *vis-à-vis* the United States and Germany suggest that full policy credibility has yet to be established. This gap is similarly reflected in the differential between yields on index-linked and conventional UK bonds of around 4½ per cent – little changed from mid-1994 (Diagram 16). Inflation expectations remain high relative to actual inflation, although the actual gap may be somewhat overstated, as risk premia on non-indexed bonds have probably increased due to greater financial market volatility.

Exchange rate trends

Since September 1992 there has been greater potential for monetary conditions to be affected by changes in sterling. Nevertheless, following an initial drop, its effective rate remained in a relatively narrow trading range from September 1992 until late 1994 (Diagram 17). The rate peaked in early 1994 and drifted down erratically through the year, before falling by some 5 per cent from end-1994 to early May. The drop against the Deutschmark has been greater, reaching record post-war lows in early May 1995.²⁷ The early 1995 weakness of

Diagram 17. EXCHANGE RATES



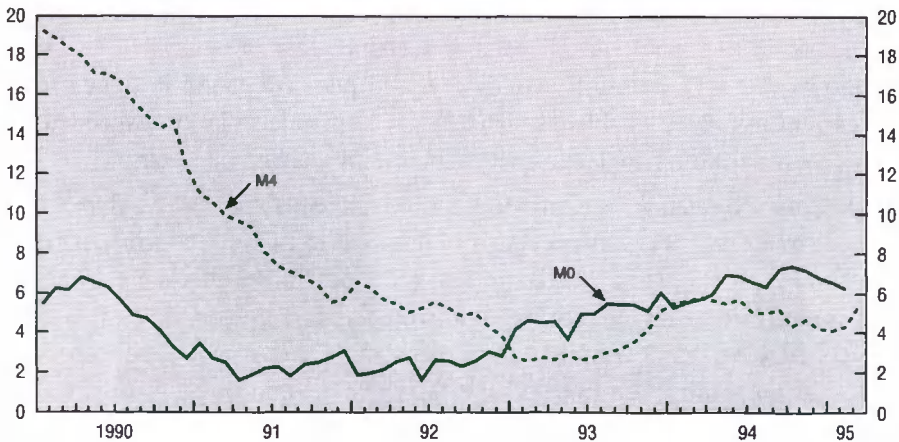
Source: OECD.

sterling does not appear to reflect economic fundamentals: inflation in the United Kingdom is at or below those of its major trading partners; the current account is close to balance and the PSBR is being brought rapidly into balance. However, uncertainty about the course of macroeconomic policy in the run up to, and beyond, the next election may be weighing on market sentiment. To the extent that the recent weakness of sterling is transitory, it would have few implications for underlying inflation. But if sustained, it would represent an unplanned moderate easing in monetary conditions.

Monetary aggregates

The monetary framework also takes note of money and credit growth in assessing monetary conditions. Monitoring ranges have been set for M0 and M4 of 0 to 4 per cent and 3 to 9 per cent, respectively. These have given conflicting signals over the past two years, with M0 growth exceeding its ceiling since the first quarter of 1993, while growth of M4 has remained at the lower end of its monitoring range in the same period²⁸ (Diagram 18). Part of the accelera-

Diagram 18. **MONETARY AGGREGATES**
Annual growth rates



Source: Central Statistical Office, *Financial Statistics*.

tion in M0 in 1993-94 might reflect the lagged effects of interest rate reductions since September 1992. But the relative strength of M0 (in the face of moderating growth in consumption and higher interest rates) is puzzling. Against a background of on-going balance-sheet restructuring, the monetary authorities have placed less emphasis on the growth of monetary aggregates as an indicator, with 'monitoring ranges' replacing the target ranges of the early 1980s.

Extending the monetary framework

The existing inflation objective will expire at the end of the current Parliament (May 1997 at latest). Thus, it needs to be updated as monetary policy decisions taken now are likely to have an effect on inflation in 1997. Although much of the academic literature on policy objectives has regarded explicit inflation targets as a second-best system in the face of supply-side shocks,²⁹ they are easily understood and can be monitored by the general public and financial markets. There is hence a strong case for maintaining inflation targets as a nominal anchor, although some technical issues merit consideration.

Inflation target ranges

If a new target range (rather than a single figure) is chosen, it must be realistic, and sufficiently stringent to build confidence and credibility. This suggests that there might be an advantage in lowering the current mid-point of 2½ per cent. Even with low inflation, year-to-year variations are inevitable. Evidence from five post-war episodes of sustained low inflation in OECD countries shows that CPI inflation was in a 1 to 3 per cent range in approximately two years out of three (Table 11). But in each episode inflation exceeded 3 per cent, as well as falling to 1 per cent or below in at least one year.

On this experience, an inflation target range as narrow as 2 percentage points is ambitious, as it was exceeded in one year in two. By contrast, a range of 3 percentage points was achieved in six years out of seven. A narrower range might initially increase credibility, but would run a greater risk of not being achieved. A wider band would be more achievable, but it would be important to ensure that the ceiling did not become the *de facto* mid-point. It might also be helpful to distinguish between short-term and medium-term fluctuation ranges. In setting the ranges it should be recognised that inflation outcomes are likely to be influenced temporarily by the state of the cycle.

Table 11. Episodes of sustained low inflation in OECD countries¹

		Number of years	Number of years of annual inflation in range				Average annual inflation rate
			Above 3	2.1-3.0	1.1-2	1 or below ²	
West Germany	1956-69	14	2	8	3	1	2.3
Japan	1982-94	13	2	3	4	4	1.6
Australia	1957-69	13	3	6	2	2	2.3
United States	1956-67	12	1	3	7	1	1.8
Canada	1956-65	10	1	2	6	1	1.8
Total sample		62	9	22	22	9	

1. Inflation measured by consumer price index.

Source: OECD.

Which measure of inflation?

There are two practical candidates for the target measure of inflation: RPIX and RPIY. RPIY automatically excludes the first-round effects of indirect tax changes as well as mortgage interest payments. It also has the advantage as a target of avoiding feedback effects on inflation if indirect taxes are changed for discretionary reasons. But RPIX is more familiar than RPIY, measures prices which people actually pay and would ensure continuity with the existing target.

In conclusion, after two and a half years of operation, the new monetary framework is working well. A major achievement has been to raise the Bank of England's profile in the policy-setting process and to heighten public awareness of the policy issues. Although monetary policy ultimately remains at the discretion of the Chancellor of the Exchequer, these features reduce the scope for interest-rate policy to be driven by partisan political considerations. In short, the monetary framework has put in place a set of institutional arrangements that have been successful in enhancing the transparency and credibility of monetary policy, notably through their emphasis that policy should be forward-looking, and act to forestall potential inflationary pressures before they materialise. Irrespective of the institutional framework, policy credibility will only be established by delivering a consistent track record of low inflation. Monetary policy in the United Kingdom remains subject to greater political control than in many other OECD countries (including the United States, Japan, Germany and France). Credibility might be further enhanced by giving the Bank responsibility (possibly with legal

backing) for deciding on the size and timing of interest rate changes needed to achieve the government's inflation objective. But such changes would raise complex issues about Parliamentary accountability.

Short-term economic prospects

The economic outlook over the coming two years is sketched out below, based on the usual technical assumptions:

- monetary conditions will remain sufficiently tight to hold RPIX close to the mid-point of the 1 to 4 per cent range;
- the government tax and spending programmes will be achieved, assuring a steady reduction in the structural budget deficit;
- the effective exchange rate remains unchanged from its 2 May 1995 level, some 5 per cent lower than its end-1994 level;
- oil prices average \$16.70 a barrel in 1995 and remain unchanged in real terms in 1996;
- market growth for UK exports of manufactures is in the 8 to 9 per cent range over the coming two years, reflecting the quickening pace of recovery in Continental Europe.

Forces acting

The main forces acting on the economy over the coming two years will be on-going macroeconomic policy restraint to slow the growth of GDP to that of potential output, and to contain inflation pressures. At the same time, strong corporate balance sheets and a competitive exchange rate will support a pattern of growth relying more on net exports and investment.

The growth in domestic demand is expected to continue at a moderate rate. But with a positive contribution from net exports, GDP growth is projected at 3.4 and 3.0 per cent in 1995 and 1996, respectively, still above the growth of potential output, albeit slowing steadily as policy restraint bites. The speed of the projected slowdown is uncertain. With GDP growth still above potential, further increases in interest rates in 1995 may be needed to assure a soft landing. But with inflation subdued, short-term interest rates are projected to peak at $7\frac{3}{4}$ per cent – at levels well below previous cycles (Table 12).

Table 12. **Short-term projections**
Percentage changes from previous period

	1993	1994	1995	1996
Volume (1990 prices)				
Private consumption	2.7	2.6	2.4	2.8
Government consumption	1.0	1.6	1.1	1.2
Gross fixed investment	0.3	3.2	4.2	4.6
Public ¹	0.6	9.9	0.4	1.0
Private	0.3	1.6	5.2	5.5
Final domestic demand	1.9	2.5	2.5	2.8
Stockbuilding ²	0.3	0.5	0.3	0.0
Total domestic demand	2.2	3.0	2.8	2.8
Exports	3.3	8.9	9.1	7.7
Imports	2.8	5.9	6.6	7.0
Foreign balance ²	0.0	0.6	0.6	0.1
GDP	2.2	3.8	3.4	3.0
<i>Memorandum items</i>				
GDP deflator	3.4	2.0	2.3	2.7
GDP at current prices	5.6	5.9	5.8	5.8
Real personal disposable income	1.4	1.2	1.8	2.3
Personal saving ratio ³	11.7	10.4	9.9	9.5
Private consumption deflator	3.5	2.5	2.9	3.1
Employment	-0.8	0.3	1.5	1.2
Unemployment rate ^{3,4}	10.2	9.2	8.2	7.6
Manufacturing production	1.4	4.1	3.3	3.0
Current balance				
£ billion	-11.8	-0.2	-0.9	-0.8
As per cent of GDP	-1.9	0.0	-0.1	-0.1

1. General government.
 2. Changes as per cent of GDP in the previous period.
 3. Data in levels.
 4. Unadjusted claimant count.
- Source: OECD estimates.

Against this background, sustained moderate private consumption growth is projected, bolstered by a pick-up in full-time employment and earnings growth. Large household financial surpluses will support consumption. However, weak consumer confidence and a stagnant housing market are expected to limit any decline in the household savings rate. Further fiscal consolidation is expected to keep the growth of public consumption and investment subdued. Business investment usually picks up at this stage of the cycle, and there are indications that investment intentions and spending on machinery and equipment are rising in response to increasing capacity utilisation, good cash-flow and strong balance

sheet positions. But to date, the recovery in business investment has been disappointing. Net exports were unexpectedly strong in 1994, and with the recovery in Continental Europe gathering pace and cost competitiveness strong, external trade should continue to support GDP growth.

Unemployment is projected to decline steadily in 1995-96, albeit somewhat more slowly than in 1994, as labour force participation rates rise in response to better employment prospects. By end-1996, the unemployment rate could be down to around 7½ per cent. This would be close to the OECD Secretariat's estimate of the 'natural rate', although ongoing labour-market reform and wage moderation suggest that this rate could be lower. Inflation measured by RPIX may rise in 1995-96, but nominal wage growth is expected to remain moderate, albeit picking up moderately in response to firmer labour markets. With low world energy prices, good productivity gains, and keen international competition, the cost positions of firms are projected to remain firmly under control. The rise in the private consumption and GDP deflators is projected to be in the 2.5 to 3 per cent range.

The trade balance is projected to improve modestly in the coming two years. Continuing buoyant exports growth is projected, reflecting a shift in the United Kingdom's relative cyclical position, a competitive real exchange rate and strong export order books. Import growth may also pick up in line with stronger investment, but with a stable invisibles balance, the current account could remain close to balance in 1995-96.

All in all, by end-1996, the UK economy could be experiencing the favourable situation of a sustainable rate of GDP growth and moderate inflation, with the unemployment rate falling close to its estimated natural rate. The current account could be near balance and the PSBR falling quickly to a sustainable medium-term position, thereby preparing the ground for a "soft landing".

The risks surrounding this projection appear evenly balanced over the short-term. The main uncertainty is the timing of the projected pick-up in investment. Higher output growth and higher inflation cannot be ruled out. But neither can lower outcomes. The major reasons why sustainable growth with low inflation is within grasp are the effects of wide-sweeping microeconomic reforms, the new monetary policy framework and a still significant output gap.

In conclusion, the settings of monetary and fiscal policies look to be on course to sustain steady output growth, while maintaining low inflation. The MTFS plots a clear medium-term path for fiscal consolidation, while the new monetary policy framework has facilitated a timely rise in interest rates at an early stage of the recovery. The challenge is to maintain this course as the recovery matures, by continuing to orient policy towards the medium-term objectives of sustained economic growth and low inflation.

III. Education and training in the United Kingdom

Introduction

There is a long-standing perception that the United Kingdom has suffered from a history of inadequate education and training. In particular, critics felt that the education system was excessively oriented to ensuring high academic standards for the elite, while standards for the majority were more variable and vocational training was undervalued. These shortcomings are often cited as a reason for Britain's relative economic decline after 1945.

In the past decade, a series of reforms have aimed to increase the efficiency and effectiveness of education and training on a number of fronts:

- government-funded education and training has been exposed to a greater degree to the operation of market forces, with the level of spending in part related to the ability of schools and colleges to attract pupils;
- the introduction of a national curriculum, designed to set standards for pupil attainment in key subjects;
- the introduction of new qualifications and certification structures, aimed at improving the quality of vocational education;
- increasing the responsiveness of education and training supply to the demands of employers, through employer involvement in designing the system of vocational qualifications and by setting up local consortia of employers to identify local training needs;
- encouraging employers and employees to engage in ‘lifetime learning’.

Although many of these reforms are still very recent, they appear to have contributed to a significant change in participation in education. The proportion of young people staying on in full-time education for at least one more year after the end of compulsory schooling has risen from 47.8 per cent in 1983/84 to

72.5 per cent in 1993/94. The proportion entering higher education has risen from 14 per cent in 1987 to 31 per cent in 1993. Participation in job training has also grown significantly. These trends have been reflected in increased levels of attainment: between 1987 and 1994 the number of people in the workforce with a qualification rose by over 4 million.

Despite this progress, it is recognised that trends in international trade and technology imply that it is imperative to maintain and improve the skills of the workforce necessary for an economy to remain competitive in high productivity industries. The United Kingdom faces three challenges: first, and most immediately, to ensure that skill levels rise sufficiently to prevent the re-emergence of skill shortages, which contributed to the deterioration in productivity growth, inflation and the trade balance at the end of the 1980s. Second, to ensure that improvements in education and training contribute to a high quality workforce, in order to reduce the “productivity gap”³⁰ between the United Kingdom and other leading economies. Third, to ensure that popular attitudes to education and training, and business values and strategies both change sufficiently to allow the United Kingdom to break out permanently from what some commentators have described as a “low skills equilibrium”.³¹

A broad consensus, including official opinion, accepts that UK skill outputs have been inadequate and remedial public action has been necessary. An unofficial commission has produced a widely supported agenda for further reforms in education and initial training (National Commission on Education, 1993). There has been less agreement, however, on the course that public policy should take. Successive governments have increasingly since 1980 undertaken a series of market-oriented reforms in both education and training as part of a wider agenda of economic revitalisation through privatisation and deregulation. The institutional landscape has been extensively reshaped. While many of the changes have gained wider acceptance, much remains controversial.

This chapter reviews the institutional changes in education and training of the past fifteen years, complementing the discussion of health service reform in last year’s Survey. The United Kingdom is first considered in contemporary comparative perspective on the basis of data available for the late 1980s and early 1990s. After outlining the attributes of UK institutions before 1980, the chapter discusses key elements of the reforms undertaken. Recent changes in activity and outputs in education and training are then reviewed in more detail, followed by

evidence on the economic benefits of education and training. There then follows a discussion of the contributions of pro-market reforms³² and areas warranting further attention. A glossary of abbreviations to guide the reader is presented in Box 1.

Box 1. Glossary of abbreviations

A-Level Advanced level General Certificate of Education

Leading upper secondary qualification, usually obtained at age 17-18 in between one and four academically oriented subjects. Universities typically specify their entry requirements in terms of A-level grades.

GCSE General Certificate of Secondary Education

Intermediate secondary qualification, usually obtained at age 15-16 in between one and ten academically oriented subjects. Introduced in 1988, to replace Ordinary-level and CSE qualifications.

GNVQs General National Vocational Qualifications

Vocationally oriented qualifications for full-time secondary studies, usually obtained at ages 16-18, accordingly to level. Intended as a route to higher education as well as directly to employment, and aimed at 'parity of esteem'.

IIP Investors in People

Initiative which encourage employers to develop high quality human resource development and management practices, offering certification when particular criteria have been satisfied.

ITB Industry Training Boards

Bipartite statutory sector-level institutions created from 1964 onwards to identify good training practice and encourage it with training grants funded by payroll levies. Only two Boards continue to function, both related to construction.

ITOs Industry Training Organisations

Non-statutory sectoral bodies, direct successors of ITBs, providing training-related advice and services to employers, funded largely from contributions and fees.

(continued on next page)

(continued)

- LEA** **Local Education Authorities**
Until the 1988 Education Act, the focus of funding and administration in all public non-university education.
- LMS** **Local Management of Schools**
Post-1988 initiative under which spending decisions have been largely devolved from LEAs to individual schools.
- NCVQ** **National Council for Vocational Qualifications**
Set up in 1986 to develop and administer NVQs; currently doing the same for GNVQs.
- NVQs** **National Vocational Qualifications**
Work based qualifications developed by NCVQ within a five level-classification and awarded by "competence" focused-assessments.
- TECs** **Training and Enterprise Councils**
Local employer-led institutions charged since 1990 with contracting for the delivery of publicly funded training, as well as identifying and meeting local training needs.
- TFW** **Training for Work**
Government funded scheme providing work based training to the adult unemployed.
- YC** **Youth Credit**
Umbrella, voucher-based scheme under which all publicly funded youth training is to be financed from 1995.
- YT** **Youth Training (previously YTS)**
Scheme to provide work-based training for unemployed young people, now being superseded by Youth Credit scheme (see above).
- WRFE** **Work Related Further Education**
Scheme to fund further education colleges for attending to local labour market needs; superseded in 1994 by the Competitiveness Fund.

International comparisons

The United Kingdom lagged behind many other advanced economies on some (but not all) indicators of education and training performance in the late 1980s and early 1990s. Such comparisons provide a useful snapshot of the training effort in different countries. Nevertheless they should be interpreted with some care, both because it is difficult to ensure strict comparability across countries, and because these are imperfect measures of the extent and the quality of investment in human capital (since the quality of investment will depend not only on the level of education and training, but also on the extent to which the training provided is relevant to the needs of the economy). The following survey reviews both input and output measures. Input data, the more readily available, indicate the level of resources devoted to education and training; output data indicate how effectively these resources are being used in developing “human capital”.

Inputs

Input-based measures include spending and enrolments. Public spending on education in the United Kingdom amounted to 5.3 per cent of GDP in 1991, more than 1 percentage point below Canada, Sweden and Norway, but roughly comparable to the United States and France and more than 1 percentage point higher than in Japan and Germany (Table 13). Public spending on higher education amounted to 1 per cent of GDP, significantly below the United States, but comparable to Germany and considerably higher than in Japan. It is difficult to obtain reliable measures of the level of spending on training by employers and individuals, but estimates suggest that this may have amounted to around 5 per cent of GDP in 1986/87. Although comparable data for employers' expenditure on training are unavailable, the proportion of national resources devoted to education and training in the United Kingdom appears to be broadly comparable with that of other leading economies.

Historically, participation rates in post-compulsory education in the United Kingdom have been low compared with other OECD countries. However, in recent years participation in post-compulsory education has risen strongly. In 1991, participation rates amongst 16-18 year olds in all forms of full-time and part-time education was 76 per cent, significantly lower than in Germany, and somewhat lower than in France, but comparable to the United States (Table 14).

Table 13. Public expenditure on education
Ranked by GDP shares

All spending	Current spending				
	Per capita in £		Higher education		
	Below higher education	In higher education	Level per qualifier	Real change, per student	
% GDP 1991	1990	1990	£ thousand 1990	Per cent 1970-85	
Canada	6.7	470	220	27.9	-22
Sweden	6.5	420	90	20.6	-13
Denmark	6.1	440 ¹	100 ¹	26.8 ¹	-25
Netherlands	5.6	320	170	38.1	-18
United States	5.5	450	140	18.0	16
Belgium	5.4	350	90	17.5	n.a.
France	5.4	380	80	11.1	0
United Kingdom	5.3	340	90	16.5	-47
Australia	4.7	280	140	22.9	0
Spain	4.5	200	40	11.7	n.a.
Germany	4.0	270	90	22.8	-24
Japan	3.7	250 ²	30 ²	n.a.	52

1. 1989.

2. 1988.

Source: Department for Education (1995), Table DD; Ryan (1992).

Table 14. Educational participation^{1, 2}
Percentages of population aged 16-18

	Full-time	All
Germany	89	89
France	87	87
Belgium	85	85
Denmark	79	79
Canada	78	78
Netherlands	78	80
Sweden	76	76
United States	75	76
Ireland	73	73
Spain	63	63
Australia	61	76
Japan	61	63
United Kingdom	43	76³

1. Part-time training counted as full-time for some countries (e.g. apprenticeship in Germany and France) and part-time in others (e.g. YT in UK).

2. 16-18 year old enrolments in education and training, circa 1991, ranked by full-time rate.

3. Includes YT which has no college element (i.e. is entirely with employers).

Source: Department for Education (1995), Table BB.

However, in the United Kingdom the full-time participation ratio was considerably lower than elsewhere.

Inputs, however, are only part of the picture. Although German and Japanese governments spend proportionately less on education than the United Kingdom, their education and training systems nevertheless attract widespread praise. The UK government has insisted that there is scope for increasing productivity in education and training. Skill outputs and stocks are prospectively more important.

Outputs

The outputs of education and training are often gauged by qualification rates, although these can be an imperfect measure of the level and quality of skills acquired. OECD data indicate that the graduation rate from secondary education in the United Kingdom is comparable to that in Canada, the United States and France, but much lower than in Japan and Germany (Table 15). However, differences in the structure of secondary qualifications across countries mean that this comparison is not very informative. In the United Kingdom, students take examinations in single subjects rather than a multi-subject examina-

Table 15. Graduation rates in upper secondary education and higher education, 1991

Percentages of population at theoretical age of graduation

	Graduation rates			Science subjects as share of degrees, universities ²
	Upper secondary		University	
	All	Vocational ¹ only	All first degrees	
Canada	72.5	0	33.3	16.1
USA	73.9	n.a.	29.6	15.3
Japan	91.1	24.7	23.7	25.7
France	75.8	45.0	16.3	n.a.
Germany	117.3 ³	93.1	12.7	31.7
Italy	50.7	32.6	9.2	17.0
United Kingdom	74.4	15.9	18.4	25.7
Sweden	80.2	60.4	12.0	26.1

1. Includes technical education and apprenticeship.

2. Natural sciences, mathematics, computer science and engineering.

3. Many graduates are older than theoretical age.

Source: OECD (1993), Tables R5-7.

Table 16. Vocational qualifications in various European economies, circa 1990
 Percentage of economically active persons of working age

	Britain 1989	France 1988	Germany 1988	Netherlands 1989	Switzerland 1991
Degree	11	7	11	8	11
Technician	7	7	7	19	9
Craft	18	33	56	38	57
None	64	53	26	35	23

Source: Prais (1993), Table 1.

tion in which satisfactory performance is required in core subjects (such as the baccalaureat in France).³³

Standardised tests provide a more reliable guide to student performance across countries. In 1990, 13 year olds in the United Kingdom scored close to the international average score for mathematics and science in tests conducted for the second International Assessment of Educational Progress.³⁴

The United Kingdom has lagged particularly in vocational education and formal training. The share of the British workforce holding a vocational qualification is low by European standards, particularly at craft level (Table 16). However, it is difficult to assess the extent to which informal on-the-job training compensates for differences in formal training at this level.

The share of science and engineering in higher qualifications has declined in recent years. In 1991, 26 per cent of the degrees awarded in university education were in science and engineering, a rather lower proportion than in Germany (32 per cent), but comparable with Japan and much higher than in the United States and Canada (15 and 16 per cent respectively).³⁵

Economic benefits

The implicit presumption behind much public discussion of education and training is that more is necessarily better. However, this view takes no account of the costs incurred. From an economic perspective, public spending on education and training can be appraised as an investment, which is worthwhile if the net present value of its expected benefits to society exceeds the net present value of expected social costs. Furthermore the costs and benefits accruing to individual

students and employers typically differ from the costs and benefits to society, so that the private decision whether or not to invest in education can be considered independently of the social rate of return.

Evidence on the net benefits of training falls into four main categories, considered below: estimates of the wage differential by level of qualification; rates of return to education; the effects of government training programmes on trainees' subsequent earnings; and the association between skills and sectoral productivity. With each approach, it is difficult to obtain a definitive answer to the question of whether further expansion (or contraction) of public funding of education is economically desirable, generally because it is difficult to quantify the full economic benefits of education and training, and to allocate how much of these benefits are "social" rather than "private" (that is how much of the benefits accrue to society as a whole rather than to the individual student or trainee).

Trends in wage differentials

Wage differentials by occupation and by level of education widened significantly in the United Kingdom during the 1980s.³⁶ Together with declining employment opportunities for unskilled labour, this has raised the prospective returns to education and training, providing a strong "market signal" that may well have been an important factor behind the sharp increase in participation rates in post-compulsory education. It is noteworthy that this increased participation has occurred despite a decline in the real value of government grants to students.

Rate of return analysis

A number of studies have attempted to estimate rates of return to education in the United Kingdom, principally rates of return to higher education (Table 17). The Department of Education estimated that the rate of return to individual students at between 20-30 per cent in the early 1980s,³⁷ suggesting that students could be asked to finance more of the cost of their own education, without a significant reduction in demand. Using a different methodology, another study estimated the private rate of return to a degree of only 5 to 8 per cent in the mid-1980s, suggesting that increasing the costs borne by students might reduce participation.³⁸

Table 17. Estimates of rates of return to schooling by level, subject area and sex for the United Kingdom in the 1980s

Percentages

Level	Subject	Private	Social ¹	Private	
		1981-85		1985-88	
		Male and female		Male	Female
		(1)	(2)	(3)	(4)
Secondary:	A-level	n.a.	n.a.	6.0	9.8
Higher education	Social sciences	32.5	12.0	n.a.	n.a.
	Engineering	34.0	7.5	n.a.	n.a.
	Natural sciences	23.5	6.0	n.a.	n.a.
	Arts	10.0	0.5	n.a.	n.a.
	All	27.5	8.0	7.1	5.8

1. Corrected for taxes and public subsidies only.

Source: Columns 1-2, Department of Education and Science (1988); 3-4, Bennett *et al.* (1992).

The Department of Education study estimated the social rate of return (which takes account of the cost of government subsidies) at 5 to 8 per cent, which is low relative to hurdle rates typically demanded for both private and public investment. However, there are a number of methodological problems associated with rate of return analysis. One problem is that the studies relate to the rates of return available to previous generations of students and may not be very relevant to the present cohort, especially in a period of widening pay differentials for highly educated labour.³⁹ In addition recent growth theory proposes that some of the benefits of education and training accrue to non-participants, by enabling faster growth of productivity and living standards.⁴⁰ Until these and other externalities are quantified, rate of return analysis will only give an approximate estimate of the true social rate of return to education and training.⁴¹

Effects of training programmes

A number of studies have evaluated the effects of public training programmes on the economic fortunes of participants. One study found that trainees on the Youth Training Scheme gained little if any improvement in pay and employment, apart from moderate employment gains for females (Dolton *et al.*,

1994). Other studies have found moderate employment gains. Training programmes for adults appear to have led to significant gains in employment and pay (Payne, 1990).

One difficulty with evaluating training programmes is to decide how immediately the effects of the training should affect employment and earnings outcomes – it has been suggested that some studies of youth training have not allowed sufficient time for the full effects of the training programme to be reflected in better employment and earning performance. Ideally, such studies should comprise a full cost-benefit analysis, incorporating programme costs and spillovers, including allowance for substitution of trainees for other employers during and after training.⁴² However, full cost-benefit evaluations have not been undertaken even by interested government departments, because it is difficult to obtain reliable estimates of such substitution effects and of expected lifetime earnings and employment profiles.

Skills and productivity

A decade of research into the relative productivity of matched British and continental plants in sectors as diverse as metalworking, clothing and retailing, has found that inadequate employee skills (particularly at intermediate level) have contributed to lower productivity in UK plants.⁴³ Inadequate skills increase downtime and manning rates on equipment, and encourage managers to steer away from the small volume, high quality products which international markets increasingly value.⁴⁴ The sources of inadequate training in intermediate skills include poor scholastic attainments in prior general education (Prais, 1993).

Scepticism has been expressed about these primarily qualitative findings,⁴⁵ although the conclusions are supported by statistical relationships across sectors between worker qualifications and economic performance in Britain and Germany.⁴⁶ This research has contributed strongly to the drive to improve the structure of vocational training and qualifications in the United Kingdom. Nonetheless, it remains unclear what role differences in intermediate skills play in explaining the productivity gap between the United Kingdom and the United States, which also has a weaker tradition of formal vocation training.

Institutional context

The situation before 1980

Although the majority of UK supply-side reforms were introduced in the early 1980s, reform in education and training largely dates from the late 1980s or early 1990s. Prior to 1980, education and training were largely distinct in the United Kingdom. Education was undertaken overwhelmingly in full-time schooling during childhood and adolescence. The secondary curriculum was broadly academic, driven by the school leaving examinations taken at age 15-16 and 17-18 (O- and A-Level, respectively) through which an elite progressed to higher education and a subset was launched into top careers by way of an “Oxbridge” degree.

Vocational studies and contact with industry were generally absent from schools. Wartime plans to develop technical schools and compulsory part-time education to age 18 had come to little. The reorganisation of secondary schooling along comprehensive lines in the 1960s actually accentuated the gap between education and training. The secondary curriculum became more narrowly focused on the academic studies involved in O- and A-Level syllabi. Vocationalism was rejected as conducive to streaming and as impeding access for working class children to better careers. Technical studies had been encouraged at tertiary level by the growth of polytechnics from the mid-1960s. Most pupils left school at the statutory age without gaining any qualifications, or even having faced any formal assessment of their learning – though the raising of the leaving age to 16 and the introduction of the Certificate of Secondary Education for lower achievers at O-Level had begun to change that during the 1970s.

Training was associated primarily with employment and the workplace. More than in other countries, employers favoured informal job training and learning-by-doing in the context of mass production and mechanisation. Sub-professional skills were certified only in craft and technician occupations, and there through time-serving rather than through skill assessment. Part-time technical education for apprentices had spread during the post-war years, but apprenticeship operated in only a subset of male-dominated occupations, where its availability declined after the late 1960s. Otherwise young people received only informal training, after having left schooling for good.

Education and training did share a tradition of decentralisation and local autonomy. State schooling was supplemented by a small and declining, but still influential, private counterpart which recruited along lines of ability to pay rather than religion or ethnicity. Central government provided the funding for public education but exercised little authority over either the Local Education Authorities (LEAs), responsible for all but university education, or the universities, autonomous bodies funded through the sector-dominated University Grants Committee (UGC). Local politicians and teachers ran the public system on administrative lines in pursuit of ill-defined and varied goals, both political and professional. The principal responsibility of central government was quality inspection; the main influence of central government had been to spread comprehensive secondary education throughout most of Britain.

Training in the private sector had been treated traditionally as the responsibility of employers and trade unions, regulated at sectoral level or below by collective bargaining or employer *fiat*. Craft-oriented unions looked to apprenticeship to regulate entry to the occupational labour markets which still functioned in much of industry. Some public responsibilities had developed, notably in the form of public training centres and, after 1964, the powers given to Industrial Training Boards (ITBs) to identify good training practice in their sectors and provide grants, funded by payroll levies, to encourage it. Nation-wide intervention arrived only in 1973 with the semi-independent, tripartite Manpower Services Commission, funded to develop and administer national training policies but increasingly preoccupied with unemployment.

The unsuitability of such education and training arrangements for a modern economy was widely recognised by the end of the 1970s, but a clear course of reform emerged only during the 1980s.

Pro-market reforms since 1980

The Conservative governments of the past sixteen years have tended to view many of the public services, including much of education and training, as inefficient bureaucracies, overly responsive to the interests of producers, particularly trade unions, professional associations and bureaucrats, rather than those of clients. These defects have been attacked by injections of market forces, including private ownership, financial incentives and competition. In private training, the preference has been for a full "training market" in which government is at

most a secondary player; in education and public training, for a quasi-market, in which government remains the key player, retaining ownership of the system and important powers of initiative, but using competition to cut costs while expanding consumer choice.⁴⁷

The effectiveness of allocating resources by markets works well when:

- large numbers of producers and customers compete, offering agents a range of choices;
- behaviour is motivated by economic self-interest, including the avoidance of bankruptcy;
- outputs are easily measurable, permitting low cost, output-based contracts;
- and external effects on agents outside particular contractual relationships are negligible.

There may be a case for administrative methods when such conditions are not satisfied, though they in turn often suffer from the inefficiencies associated with bureaucratic inertia and political volatility (Finegold, 1995).

Policies which have promoted conditions favourable to market forces are considered in this section. The emphasis is placed on complementarities and coherence within the pro-market agenda. Policies which exceed or conflict with market requirements are discussed in the following sections.

A distinction is drawn between institutional reforms, which are intended to endure, and particular policies – or “initiatives” – which attempt to achieve specific objectives within the wider institutional framework. The leading contents of the two categories are listed in Tables 18 and 19.

Private provision

The development of markets in the public sector has been encouraged partly through private provision. Public assets have been sold; the delivery of publicly financed services has been contracted out. Commercial organisations face profit-oriented incentives to respond to customer demand, reinforced by the threat of bankruptcy or take-over if they fail. Education and training offer considerable scope for privatisation and external contracting to increase competition: economies of scale are limited and many external providers, for-profit as well as non-

Table 18. Institutional changes in UK education and training

Category	Attribute	Date of introduction	Current status: agents involved	Date
Privatisation	Assisted places scheme	1980	£92.3 million	1993/94
	School inspection	1993	All State schools	1994/95
	Skillcentres	1990	0	1995
Output measures: Schools	National curriculum Standard	1990-95 1990: 7 years 1993: 14 years 1995: 11 years	All state schools, E&W Widespread union boycotts ended	Sept. 1995 1994/95
	Assessment Tasks	1991/92	Public exams and 11 year old SATs	1994/95
Higher education	Research and teaching assessments	1992; 1994	Second research assessment; first teaching ones	1996; ongoing
Training	NVQs	1986	86 per cent of workforce covered by 735 qualifications for 150 occupations	1995
	Publication of TEC outcomes	1993	Second year's tables	1994
Parental choice	Open enrolment	1990	All state schools	1995
Money incentives: Education	Formula funding	1990	All state schools	1995
	Performance related pay	1993 pilot for heads	14 schools	
Training	Output-related funding	1990	25-100 percent of TEC revenue for TFW	1993/94
Reduction of LEA powers	Grant maintained status	1990	1 007 schools	1994
Vocationalism	GNVQs	1992	56 000 pupils (excl. Foundation)	1993/94
Employer leadership and co-operation	Training and Enterprise Councils	1990/91	104 TECs and LECs	1995
	Industrial Training Boards	1964	2 Boards	1995
	Industry Training Organisations	1982 and 1991	127 ITOs	1995

Source: Employment Department, Skills and Enterprise Executive, May 1994; *Financial Times*, 8 January 1995 and 16 June 1994; Department for Education, *Statistical Bulletin*, Number 10/94, July 1994.

Table 19. **Leading current education and training initiatives**

Category	Initiative		Coverage	Date
Vocational education	Technical and Vocational Education Initiative	Great Britain	5 000 schools	1992/93
Labour market links	Competitiveness Fund	England	£20 million p.a.	1994/95
School-business links	Compacts	Great Britain	83 schools	1992/93
	Education Business Partnerships	England and Wales	120 schools	1993
	Enterprise in Higher Education	Great Britain	60 institutions	1993
Training exhortation	Investors in People	Great Britain	330 companies recognised	1993
	National Training Awards	United Kingdom	94 awards	1992
Training subsidies:				
Employers	Youth Training	Great Britain	204 000 trainees	1994
	Modern Apprenticeship	Great Britain	1 000 apprentices in 17 fields ¹	1994/95
	Training for Work	Great Britain	136 000 trainees	1994
Individuals	Youth Credits	Great Britain	50 000 trainees	1994
	Career Development Loans	Great Britain	39 000 loans extant	1993
Guidance	Tax relief for vocational course fees	United Kingdom	£10 million claimed	1993/94
	Skill choice	Great Britain	250 000 individuals	1994/95

1. Programmed to rise to 70 000 apprentices after 1996/97.

Source: Employment Department (1993), Table D8, (1994); *Labour Market Quarterly Review*, August 1994; Felstead (1993).

profit, compete for business. Privatisation has been pursued more extensively in public training than in education.

In training, the government favours a division of responsibilities in which employers and employees take care of their own training within a full scale training market, while government takes responsibility for training the unemployed and for young people entering the labour market for the first time (Employment Department, 1988). In the government's area of responsibility, public training programmes have been converted from public to private delivery by privatisation and external contracting. In adult training, public facilities have been closed or sold. Training for unemployed adults has since 1990 been delivered entirely under contracts with external providers, among whom private companies have become increasingly numerous.⁴⁸

Private provision has also been encouraged in education. Private schooling has been encouraged to expand primarily through the Assisted Places Scheme, which funds a number of places in independent schools for state sector pupils from lower income backgrounds. Helped also by the fiscal squeeze on public education, private schools have since 1979 expanded their share of secondary enrolments to 11 per cent.⁴⁹ The chartering of the private University of Buckingham apart, higher education continues to be provided wholly by what are in effect public bodies, although these have obtained an increasing proportion of their income from private sources.

Some ancillary services have been contracted out, including school meals and careers advice. Schools inspection has now joined them: HM Inspectorate has been replaced in England by Ofsted, whose external contractors must involve lay members in their inspections. Schools and universities have been variously encouraged or required to develop private sources of income, from parental contributions, facility rentals, conference fees and foreign student tuition payments.

Core educational functions continue, however, to be provided largely by state schools and colleges at all levels. Instead of private provision, government has opted for a quasi-market, in which it retains ownership and finances activity through the tax system, while inserting market-like relationships between public suppliers and their customers.

Output measurement

One of the above conditions for markets to work is the measurability of output – as opposed to that of inputs, the traditional locus of administrative control. The traditional view of the outputs of education as heterogeneous and nonquantifiable has been discarded. Outputs are nowadays defined for schools as pupil learning in core disciplines, relative to the attainment levels specified by the National Curriculum, as developed under the 1988 Educational Reform Act. The curriculum, as it stands after the 1994 Dearing report, applies to all students between ages 5 and 16 in state schools in England and Wales. Curriculum requirements are estimated to take up 60 or 80 per cent of lesson time, according to pupil age, in up to ten subjects, among which English, maths, science and technology are both core and compulsory throughout.⁵⁰

The National Curriculum promotes output measurement by expecting that children will study stipulated topics in each subject by four ‘Key Stages’ (ages 7, 11, 14 and 16) and by providing for assessment, at each Stage, of each child’s progress relative to attainment targets, coded on eight point scales. The most able pupils are expected to attain point eight by age 14. Pupil scores on these assessments, in addition to GCSE and A-Level grades, provide potential measures of educational output, for pupils, teachers and schools alike.

That potential has been pursued by publishing ‘performance tables’, which compare the outcomes achieved by individual schools, confined initially to grades in public examinations, but currently including truancy rates and time spent in lessons. The informational value of the early performance tables was marred by reporting errors and the lack of any adjustments to allow for differences in pupils’ prior attainments and social background. The initial controversy over the tables appears to have abated and a regular flow of output measures assured for the future. Moreover, the frequency of school inspections is being increased to provide all parents with an annual summary of the inspectors’ report on the performance of their children’s school.

Output measurement in higher education has been encouraged by creating a unified administrative structure for the sector. Teaching quality and research output are now assessed for each institution within particular disciplines, by the Higher Education Funding Council and the Research Councils respectively, and the results published.

Table 20. National training targets and achievements by National Vocational Qualification level
Percentages

NVQ attributes		National education and training targets ¹						
Level ²	Occupational range	Category ³	Criterion	Achieved			Target	
				1985	1992	1993 ⁹	1996	2000
1	Routine	–	–	–	–	–	–	–
2	Operative	F1	Population, qualified ⁴	44	55	61	80 ⁵	85
3	Craft	F3	Population, qualified ⁴	27	34	37	–	60
		L1	Employees, qualified ⁴	28	33	38	–	60
4	Technician	L2	–	–	–	–	–	30
5	Professional/ managerial	–	–	–	–	–	–	–
All		–	Workers, training for NVQ ⁶	n.a.	n.a.	3	50	–
Other		–	Employees, in training ⁷	33 ¹⁰	54 ¹⁰	48 ¹⁰	100	–
		L3	Per cent of employers rated IIP ⁸	0	<1	2.5	50	35/70 ¹²
			18-19 year old population, Higher Education	14 ¹¹	n.a.	31	–	33

1. Targets for year 2000 are new targets announced in 1995. One target is not shown: F2 ("75 per cent of young people to achieve level 2 competence in communication, numeracy and IT by age 19; and 35 per cent to achieve level 3 competence by age 21").
2. The competence levels underlying NVQs are specified as requiring (*Labour Market Quarterly Review*, February 1993): Level 1: the performance of a range of varied work activities, most of which may be routine and predictable; Level 2: a significant range of varied work activities, performed in a variety of contexts. Some of the activities are complex or non-routine. Collaboration with others may be a requirement; Level 3: a broad range of varied work activities performed in a wide variety of contexts, most of which are complex and non-routine – considerable responsibility and autonomy, and control or guidance of others is often required; Level 4: a broad range of complex technical or professional work activities performed in a wide variety of contexts and with a substantial degree of personal responsibility and autonomy. Responsibility for the work of others and the allocation of resources is often present. Higher targets have been adopted for Scotland.
3. F and L indicate Foundation (19-21 year old) and Lifetime (i.e. all ages) targets respectively.
4. Or academic equivalent (see Box 2).
5. 1997 target.
6. Including units towards an NVQ.
7. Employees aged 19/20 to 59/60 who have received training during previous 3 years.
8. Investor in People; medium to large employers only.
9. Detailed criteria altered for some targets during 1993.
10. Varying bases, implying unreliable trends.
11. 1987 data.
12. 35 per cent of organisations employing more than 50 people, 70 per cent of organisations employing more than 200 people.

Source: *Labour Market Quarterly Report*, August 1993, August 1994; *Skills and Enterprise Executive*, May 1994; Department of Education and Science 1991; *Financial Times*, 20 June, 4 December 1994.

Output measures have also been developed for a training market which previously lacked a common set of qualifications which are widely accepted by employers. The National Council for Vocational Qualifications (NCVQ) has since 1986 systematised and built on the existing set of qualifications with a view to permitting all workers to become eligible for formal skill certification.⁵¹ The resulting five level set of National Vocational Qualifications (NVQs) now covers 86 per cent of the workforce, but how and when the professional qualifications at Level 5 will be incorporated remains to be determined (Table 20). A parallel range of general vocational qualifications (GNVQs) is currently being introduced in upper secondary education. (For a representation of the broad equivalences between NVQs, GNVQs and General Education, see Box 2.)

Box 2. Qualification equivalents

NVQ levels and description	GNVQ levels	General Education
5. Professional/managerial	–	Higher
4. Technician	–	Higher
3. Craft	Advanced	2 A-levels (or equivalent in AS)
2. Operative	Intermediate	5 GCSEs at grades A to C
1. Routine	Foundation	at least 4 GCSEs at grades D to G

The activities of training providers are now judged increasingly by the number and level of the NVQs obtained by trainees – instead of just enrolments or training weeks provided. Similarly, the efforts of the Training and Enterprise Councils (TEC) which have since 1990/91 organised public training programmes at local level are indicated by several output measures, including qualification rates and costs per qualification, some of which have since 1993 been compiled into league tables and published (Felstead, 1994).

Competition and choice

The choices facing customers of education and training providers have been widened through decentralisation and deregulation. Schools are encouraged to compete for the business of an increasingly informed parental clientele. In primary and secondary education, decision making powers have been extensively devolved from Local Education Authorities (LEAs) to parents and schools. The 1988 Act stipulated "open enrolment", increasing the ability of parents to choose between schools by removing from LEAs the power to impose intake limits on particular schools and requiring schools to respond to requests from parents to transfer, albeit subject to capacity limits. Under "formula funding", the budgets of LEAs are set by a standard national formula, and their allocation to schools is closely related to enrolments. Under Local Management of Schools (LMS), most school spending decisions are made by the school itself rather than by the LEA, as had previously been the case. LEAs are required to distribute 85 per cent of their budgets directly (and, thus far, more generously) to local schools. Finally, schools have been encouraged to opt for "grant maintained" status, under which they are funded directly by the national Funding Agency for Schools rather than by their LEA, and increased powers are given to school governors. The decision is, however, left to a majority of parents rather than to governors or head teachers.

In both further and higher education, public funding has been brought wholly under new national Funding Councils, and based increasingly on enrolments. Universities have been encouraged to compete for enrolments, initially through a formal bidding procedure and subsequently through increases in government-funded tuition fees.

Competition has also been encouraged in the public training quasi-market. Although their areas of operation do not overlap, TECs compete at the margin for government funding of public programmes. Training providers compete in turn to deliver the programmes to TECs. In addition, all youth programmes are currently being brought under Youth Credits (YC), which offer all early school-leavers training vouchers which they can use to buy, from the provider of their choice, training to at least NVQ Level 2. Training providers and employers are expected to compete to train YC holders, who are in turn provided with increased careers guidance to help them make informed choices.

The effectiveness of competition in quasi-markets can be curbed, however, if there are other important influences or constraints that limit the extent to which the system can respond to market signals.⁵² The popular schools which are supposed to expand their enrolments in response to parental demand often do not want to do so, and are able to refuse to do so once they are “full” (Adler, 1993). The unpopular schools which are supposed to close to release resources may be allowed to continue by public authorities which wish to avoid political conflict (a situation akin to the problem of closing hospitals). Some small schools facing closure by their LEA have been able to avert the threat by opting for grant maintained status. Transport costs and community ties also limit competition. Many parents wish their children to attend a local school and there may not be a “good” one within their locality. The main vehicle of inter-school competition is, thus, likely to be a professional desire to improve performance rankings rather than high pupil mobility or parental influence.

Process deregulation

Improved measurement of outputs has been complemented by reduced interest in regulating inputs, which previously featured prominently. Consistent with a view of market functioning in which only decentralised decisions can tap local information, education and training managers are freed to pursue output goals by the methods they judge appropriate.

In schools, the managerial powers given to governing bodies and head teachers under LMS have been augmented by new public regulations concerning classroom staffing, physical facilities and teacher training. Calls to adopt maximum class sizes along Scottish lines have been rejected. Payscales for teachers are set nationally, but under LMS schools have scope to determine the position of teachers on the payscales. State-funded schools in the independent sector are able to develop their own payscales and employment practices. Thus far, only a few schools have done so. In further education, colleges have been pressed to negotiate more demanding contracts, including longer hours of work, with lecturing staff.

In training, the NCVQ has adopted an output-oriented approach to qualification. NVQs are based on standards of competence for particular occupations, determined by business. Assessments for NVQs are concerned with competence in the job role, irrespective of how the relevant skills were acquired – in marked

contrast to the process-oriented requirements, such as time spent in training, hours spent in classwork, which previously applied in apprenticeship, for instance. The costs of training are reduced by excising unnecessary material and avoiding inefficient training methods. The benefits of training are increased by ensuring that qualifications focus on the key skills required by employers. In addition, access to qualifications has been extended to many workers previously excluded, whether by process requirements which they found it difficult to satisfy, by age restrictions on entry to training or by excessive training costs (Jessup, 1990).

Financial incentives

Output measurement not only facilitates effective contracting, it also permits agents' incomes to be linked to performance, creating pecuniary incentives to attain high performance. When their incomes are tied to output indicators, market agents face potentially powerful incentives to deliver high levels of those indicators. The incomes of a wide range of agents in public education and training, including schools, colleges, universities, TECs, training providers and individual employees, have been tied to measured performance.

In education, the linking of funding for schools and colleges to enrolments rewards popular institutions and encourages them to provide the services demanded by parents. Schools have also been encouraged to compete for the additional public funds provided by particular programmes, such as those for vocational education under the Technical and Vocational Education Initiative (TVEI) (*cf.* Table 19). The government has encouraged schools to pay teachers in shortage subjects and shortage regions more than others. In higher education, research funding is now significantly dependent on the university's rank in recent research assessments; similar developments are expected for teaching, drawing however on assessments of methods rather than results. In public training, contracts for adult and youth training between both government and TECs, and TECs and providers, are currently moving towards output-related funding and in some instances are already based wholly on outputs.

Money incentives have also been injected for individuals, notably through merit pay and performance-related pay in public education. Pay settlements for universities allow them to adopt discretionary payments for individuals and to differentiate pay within grades, preferably according to merit and scarcity.

In private training, employers have been encouraged to offer more training by reducing trainee pay and employment protection. Young people were taken out of minimum wage coverage in 1986, well before statutory minima were abolished. Standard terms and conditions in public training have stipulated low allowances instead of ‘rate for the job’ wages, and fixed-term training contracts instead of open-ended employment ones, thereby reducing the payroll costs of training.⁵³

Beyond the market

The government has not seen the enhancement of market forces in education and training as in itself sufficient to realise its education and training goals. In training, in particular, agents have been exhorted to invest more than they would choose to if left to their own devices. Detailed guidelines have also been applied throughout education and training in order to achieve particular outcomes. Moreover, while market-related reform has in many ways decentralised decision making, reverse movements have also been marked. The powers of LEAs have been transferred upwards as well as downwards. Central government has taken new powers of direction and control, notably in the Department for Education’s promulgation of the National Curriculum. A range of quasi-governmental organisations now regulates from the centre such educational functions as curriculum, assessment, careers, inspection and funding.

A sustained campaign of exhortation, publicity and prizes encourages agents to undertake more training. White Papers and official periodicals regularly proclaim the value of training to agents who are seen as insufficiently appreciative of this. The Investors in People (IIP) award, for which businesses can qualify by satisfying training-related criteria, has received considerable publicity, as have the recipients of the annual National Training Awards.

Overarching such activities stand the National Education and Training Targets, which stipulate rates of participation and qualification by the year 2000 for both youth and all categories of workers, representing Foundation and Lifetime categories, respectively. The three key targets call for 60 per cent of employees, both young and adult, to be qualified at NVQ Level 3 – equivalent to a craft apprenticeship or two A-Level passes – and for 70 per cent of medium- to large-sized employers and 35 per cent of smaller employers to be IIP certified by

the year 2000. The youth participation rate in higher education is targeted at 33 per cent for the same year (*cf.* Table 20).

A number of initiatives are aimed at increasing "lifetime learning". Skill Choice is an adult vocational guidance programme, which has helped nearly 250 000 people to develop action plans and initiate acquisition of NVQs. The Investors in People initiative encourages businesses to develop career development programmes for their employees. Career development loans provide financial assistance to trainees.

Government has also turned to regulation and subsidies to encourage outcomes which are unlikely to be realised under market-based choices alone. The main focus has been on education, where quasi rather than full markets have been adopted partly because government wishes to retain control over the overall scale and direction of the educational system.

The first and foremost instance is the National Curriculum, whose objective is "to provide a broad and balanced curriculum for all pupils". The curriculum specifies what should be learned and is intended to increase pupil attainments, particularly in reading, writing and mathematics. The adoption of the curriculum implies that parental power and inter-school competition are not considered capable of achieving such goals on their own.

A second area is the encouragement of vocational subjects in an upper secondary curriculum traditionally dominated by academic ones. The Technical and Vocational Education Initiative has since 1983 funded programmes offering technical and vocational training to 14-18 year olds. Work-Related Further Education and its successor, the Competitiveness Fund, encourage colleges to be more responsive to local labour market needs when planning and developing courses. The National Council for Vocational Qualifications has recently developed General NVQs for full-time studies at age 16-18 with considerable success, and plans during 1995/98 to pilot GNVQ Part Ones for 14-16 year olds.

Third, business values and school-business links are promoted, to alter an educational ethos seen as detached from, and even hostile to business methods and values. Companies have been encouraged to enter into compacts with local schools, offering recruitment and training rewards to pupils who achieve attendance and examination targets. Education-Business Partnerships encourage schools and employers to develop a variety of contacts, including company

provision of work experience for pupils and teachers.⁵⁴ Some City Technology Colleges were set up in the 1980s as technology-oriented secondary schools with curricular orientations towards local business, which was in turn expected to help fund them. In higher education, public funding has been taken from the University Grants Committee and LEAs and vested in the Higher Education Funding Council, whose membership contains extensive business representation. Enterprise in Higher Education funds projects which promote student awareness of business issues and values.

Fourth, publicly financed training has been re-oriented. Off-the-job training has moved towards on-the-job methods, with work experience in a central position. The goal has been to relate training more closely to the needs of employers and give trainees an early introduction to actual employment. Requirements that YT trainees spend at least one-fifth of their time in off-the-job training were discarded in 1990. Adult schemes were converted to largely work-based provision in 1987/88, when the precursor of Training for Work was launched. The competence which NVQs certify is defined in work-related terms; it is assessed where possible on the job itself and, where not, at least partly, through simulated work experience. In education, almost all upper secondary students now undertake some work experience.

Finally, government has extended its responsibility beyond that for training the unemployed and increased significantly its support both for mainstream youth training and for individually sponsored training. There is a guarantee of a place on Youth Training to all unemployed school leavers who want one. The conversion of Youth Training to the Youth Credits (YC) format will entitle all school leavers to a voucher through which they can obtain public funding for training. YC will also be the mechanism through which young people can access a new system of government supported "Modern Apprenticeships", offering substantial public funds for craft and technician training. These expanding public commitments suggest that market-led decisions are not seen as fully adequate in youth and intermediate skills training.

Assistance to individuals who want to sponsor their own training can be justified by market failure in the finance of human capital, as well as by non-price rationing of employee access to employer-sponsored training.⁵⁵ Public subsidy to training sponsored by individuals who are ineligible for unemployment-related programmes has increased considerably. The introduction of Youth Credits is a

leading component. Career Development Loans give individuals interest-free loans to finance tuition fees and some living costs during vocational courses lasting up to one year. Since 1992, under the rubric of tax relief for training, public funds have offset one quarter of the course fees payable by individuals taking NVQ-related courses “off the job”.⁵⁶

Public assistance to individuals has long been taken for granted in higher education, where the United Kingdom still provides exceptionally high rates of public subsidy to the tuition fees and living costs of full-time British students studying for first degrees. Support levels have been reduced, by cutting the real value of the maintenance grant and converting it progressively into a low interest loan, but tuition costs for full time British (and EC) participants are still paid entirely from public funds (Department of Education and Science, 1988).

Intermediate training institutions

Almost all of the intermediate institutions standing between economic agents and the training market which had been instituted between 1964 and 1979 – notably the ITBs and the tripartite Manpower Services Commission (MSC) – had been abolished by 1991. The ITBs were converted into non-statutory Industry Training Organisations, dependent for funding mostly on voluntary employer contributions and sales of training services. Two construction-related Training Boards have, however, been allowed to operate until at least 1998, consistent with the increase in craft training in construction under their aegis during the 1980s and the implications of their closure for a sector dominated by small firms and self-employment.⁵⁷

A new type of intermediate institution has also been created: the Training and Enterprise Council. The organisation of public training programmes was during 1988-90 devolved from the MSC and central government to a network of 104 local TECs.⁵⁸ This was intended to allow training programmes to be tailored more effectively to meet local needs and to ensure better co-ordination of public and private training activity. TECs are incorporated businesses, operating on commercial criteria and charged with mobilising local business interests in pursuit of local training needs and national training goals. Their boards are comprised primarily of senior local managers; educational and trade union representation is marginal. TECs receive public funding (£1.8 billion in 1993/94), tied to national programmes, but they lack powers to require the membership or support

of local employers and remain heavily dependent on government funds. The TEC role is, however, broadly consistent with the pro-market agenda. In public training, competition is supposed to govern their funding and subcontracting; in private training, they are expected to encourage and exhort private agents, but enjoy no public powers and modest public funding.

Recent developments in activities and outcomes

The long-term trend towards increased participation in post-compulsory education has accelerated in recent years. Until 1990, more than one-half of young people left full-time education by age 16; by 1993, the share had fallen to 31 per cent.⁵⁹ The upward trend in the participation rate for 16-18 year olds as a whole has accelerated markedly. Participation in higher education among 18-19 year olds has more than doubled recently, rising from 14 to 31 per cent between 1987 and 1993 and closing rapidly on the official target of 33 per cent by 2000 (*cf.* Table 20). Post-16 participation has increased particularly rapidly for vocational courses. The share of 16 year olds taking a full time vocational course rose between 1989/90 and 1993/94 from 17 to 28 per cent.⁶⁰

This rapid increase may have been partly a response to the lack of employment opportunities during the recession. However, the fact that the beginning of the increase predated the recession, and the scale of the increase has been much greater than in the early 1980s suggest that this reflects a more permanent development.⁶¹ Higher staying-on rates may also prove significant in the long-term, as “peer group influences” enhance the desirability of continuing education beyond the compulsory school leaving age. Although the increase occurred as cohort sizes declined, the absolute number of young people in education has also risen strongly, increasing for full-time courses by nine percentage points between 1992 and 1993 alone⁶² (Table 21).

Participation in job training has also grown significantly. The share of employees receiving training in the previous month rose from 8 to 14 per cent between 1984 and 1994. In contrast to education, however, the entire increase in training occurred during the 1980s. Economic recession held training activity below its 1990 peak until the end of 1993, albeit less severely than in the previous downturn.⁶³

Table 21. **Educational and economic activity of 16-18 year olds, Great Britain, January 1976-92**

Percentages of population aged 16-18 on 31 August of previous year

	1976	1981	1986	1992
Full-time education	27	28	31	47
Part-time education ¹	14	13	8	7
Training schemes	0	5	10	11
Other ²	59	53	50	35
Population (thousand)	2 409	2 748	2 633	2 126

1. Day courses in public sector only (excluding YT courses), taken by employed and unemployed.

2. Employed (ex-YT), unemployed and residual.

Source: Department for Education (1995), Table 19.

There are signs of increased interest in continuing training amongst individuals already in the labour market. Nearly 250 000 people have received guidance on vocational training through the Skill Choice programme. Nearly £13 million was claimed in tax relief on vocational course fees in 1994/95, while the proportion of individuals funding their own training rose from 9 per cent in 1987 to 17 per cent in 1993.

Outputs have also grown rapidly. The trend decline in the share of young people not taking or passing a public examination at age 15-16 has accelerated since 1980, while the share gaining a pass at A-Level at age 18 has risen from 20 to 32 per cent. However, a large minority still leaves school at 16 with at most mediocre grades in a small number of subjects (Table 22).

Qualification in vocational education, which will until 1996 remain restricted to 16-plus studies, has also grown rapidly. Led primarily by the Business and Technology Education Council's National awards, full-time vocational outputs have grown so rapidly as to provide a broad equivalent to the intermediate vocational routes developed earlier in France (Green, 1995). The early popularity of GNVQs among 16-18 year olds suggests that rapid expansion of vocational outputs will continue.

Gains have also been registered in work-based training, which is certified through NVQs. The diffusion of NVQs has, however, been much slower than that of school-based qualifications. It has been held back in some sectors by design problems,⁶⁴ as well as by the 1990-93 recession. Nevertheless, the Labour

Table 22. **Scholastic attainments in secondary education,
United Kingdom 1970-91¹**
Percentages of relevant age group

	1970/71	1975/76	1980/81	1985/86	1990/91	1991/92
Advanced level:						
1 + pass, any grade ²	n.a.	19	20	22	28	32
Ordinary/GCSE:						
5 + passes, higher grades ²	7	8	9	11	12	13
Ordinary/GCSE:						
Other grades ²	27	52	55	59	49	46
No grades	44	19	14	12	8	6

1. Academic qualifications only.

2. Bases differ across rows; Scottish equivalents included.

Source: Department for Education (1994), Table F.

Force Survey indicates that 750 000 employees, accounting for 3 per cent of all employees, either hold an NVQ or are training for one. 30 per cent of employers offered NVQs to some or all employees in 1994, a marked increase over the 24 per cent reported for 1993. Progress has been patchy in publicly financed training. The proportion of YT/YC and TFW participants gaining a qualification is indeed much higher than it was seven years ago, when NVQs first became available and output-related funding had yet to be introduced.⁶⁵ Nevertheless, significant numbers leave YT and TFW without any qualification or only one at a very low level.

To date, NVQ attainments have been uncomfortably slanted towards lower levels. Nearly one-quarter of awards in early 1994 were at Level I, covering "routine and predictable" tasks; only 15 per cent were at craft (Level III) or above. The proportion accounted for by Level I awards, which contribute little to the United Kingdom's skill needs, has certainly declined markedly from its 1990/91 level of one-half and it is expected that the share of higher level qualifications will increase as the new system matures. Nevertheless, employer-provided training remains predominantly short, informal and uncertified – and part of the 1984-90 increase was simply a response to changes in health and safety regulations. Although some 770 000 NVQs have now been awarded, the revolution in employer-sponsored training which NVQs have been expected to facilitate is progressing at a slow pace.⁶⁶

Table 23. **Highest qualifications held,
United Kingdom, 1984-92**

Percentage of population aged 16-59

	1984	1992
Degree and equivalent	7	10
Other higher	6	7
Higher technical	n.a.	3
Teaching and nursing	n.a.	3
GCE A and equivalent	22	26
A levels	n.a.	7
City and Guilds certificate	n.a.	10
Technical	n.a.	3
Apprenticeship completed	n.a.	6
GCSE/O and equivalent	16	19
Other qualification	9	10
None	39	27
Total	100	100

Source: Department for Education (1994), Tables 38, 40.

Taken as a whole, these increases in education and training outputs have already augmented significantly the stock of qualified labour in the United Kingdom. The proportion of people of working age holding no qualification declined by nearly one third between 1984 and 1992. The incidence of qualifications increased noticeably at intermediate level, where shortages in the United Kingdom have caused most concern (Table 23).

Output increases have also improved the prospect for meeting national education and training targets, at least at youth level. The youth target for higher education participation has almost been reached already; those for Levels 2 and 3 look likely to be attained as well (*cf.* Table 20). Work-based qualifications – NVQs – are, however, contributing only weakly to progress. In the youth category, academic and vocational qualifications are making the running. The CBI, the leading employers' organisation, has called for target participation in higher education to be raised to 40 per cent, but further increases have instead been suspended for four years, in view of their implications for public expenditure.⁶⁷ In the adult category, where increases in academic qualifications are less likely, and where work-based qualifications have been introduced relatively recently, the targets are more challenging, and a higher rate of progress is

needed if they are to be achieved. The situation is similar for the Investors in People target for employers.

Towards an assessment

The links between changes in participation and outputs and those in institutions and policies are varied and difficult to disentangle from broader environmental changes that affect behaviour. For example, changing signals from the labour market and a shift in peer group attitudes may have contributed to increased youth participation in full-time education. The post-1989 recession reduced employment opportunities for less qualified workers and intensified credential-based competition for jobs. Rapidly increasing demand for highly educated labour has increased its relative pay and curbed graduate unemployment. It remains to be seen whether the labour market will adequately reward the increasing number of young people who opt for full-time vocational studies at age 16-18. Again, the upward trend in measured training incidence may have been generated partly by the repackaging of training away from extensive courses taken early in working life – as under apprenticeship training for occupational markets – towards the sequence of shorter doses associated with recruitment and promotion in internal labour markets, as a result of underlying changes in the organisation and management of work within enterprises.⁶⁸

Nevertheless, it is clear that reforms have spurred significant increases in outputs and efficiency in many areas of public education and training, and their contribution should increase as recent reforms – *e.g.* the introduction of the National Curriculum, NVQs and GNVQs, and assessments of research and teaching in higher education – settle down. More precise assessments will become possible as the availability and reliability of output measures increase.

The reforms appear to have improved educational efficiency and outcomes in several ways. In higher education, almost one in three young people now study for a degree, compared with just one in seven in 1987. Between 1989-90 and 1993-94, participation in full-time and part-time education at schools and colleges has risen from 70 to 80 per cent at age 16 and from 56 to 67 per cent at age 17. Many other 16 and 17 year olds receive education and training in independent institutions or from employers under the Youth Training scheme.

Higher participation has been accompanied by higher attainment. The proportion of young people achieving two or more A-level passes rose from 17 per

cent in 1988-89 to 28 per cent in 1993-94, while the proportion of 15 year olds passing 5 or more GCSEs at grades A to C increased from 26 per cent in 1986-87 to 43 per cent in 1993-94.

Schools are using the increased flexibility provided by Local Management of Schools (LMS) to employ more classroom assistants, give responsibility payments to valued staff, and raise revenue by hiring out school facilities. Most head teachers see LMS as having already increased their school's performance. Published tables of exam results have increased local demands for improved performance by schools.⁶⁹

In higher education, research assessment has encouraged less productive staff to increase their efforts and their departments to help them to do so. Teaching assessment is starting to overcome widespread indifference to pedagogic success. Many universities have developed innovative teaching programmes, attracted more overseas students and reduced their dependence on public funds.

In public training, output-related funding and competition for places have driven down costs per trainee and contributed, albeit thus far to an only limited extent, to increased qualification rates. TECs have encouraged many innovations in training practice. Commercialisation has created a new breed of training entrepreneur, whose ability to meet qualification targets substantially exceeds those of traditional providers.

In general, the exposure of public provision to the influence of market signals, and increased use of performance measures have resulted in a system in which the pattern of education and training is driven much more by the demands of students and employers, rather than the preferences of producers. There are a number of potential problems warranting further attention, outlined below. In addressing these, it will be important to ensure that the reductions in unit costs, and improved responsiveness of the supply of education and training to the demand of students and employers are maintained.

Areas warranting further attention

Output measurement and financial incentives

Electronic technologies make it cheaper to measure outputs and the National Curriculum assessment tests should provide standardised measures of educational

outputs. Nevertheless, output measurement remains more difficult in education and training than in many other sectors. The first problem arises from the multi-dimensionality of outputs: the costs of assembling and aggregating information are high. Secondly, the qualitative nature of many output dimensions means that indicators are often intrinsically incomplete, as such dimensions cannot be measured accurately.⁷⁰ Educational testing is forced to rely on a subset of relatively measurable outputs, which may result in ‘teaching to the test’ in ways which neglect, and even conflict with, wider educational and cultural objectives.

It has been argued that NVQs are particularly vulnerable to output distortion because of their focus on the outcomes of training and the absence of training process requirements.⁷¹ In principle, injecting written tests and external assessment alongside work-based tests would ensure that candidates display wider occupational competences and underpinning knowledge. However, the NCVQ argue that their existing guidelines already require that candidates display such knowledge. A review of the quality and rigour of the 100 most frequently used NVQs has been launched, to consider how effectively knowledge and understanding are assessed in practice. It is important to ensure that the quality assurance arrangements required by NCVQ are operating effectively.

Thirdly, the outputs upon which policy should focus are net ones, such as how much has been learned during a particular course, whereas most measures are gross ones, such as what grades have been earned. The difficulty of controlling for prior attainments in schooling in order to measure value added outputs will undoubtedly fall as National Curriculum test results at the earlier stages become available as indicators of pupils’ ability and previous attainments.⁷² Such controls cannot, however, be more than partial and some reputations will still depend on gross outputs.

The problem of unmeasured outputs becomes potentially more serious when financial incentives are present, as under commercial contracting in general and output-related funding in particular. Tying rewards to outputs encourages performance in the dimensions stipulated, but offers no incentive to outputs within non-stipulated dimensions – and it encourages substitution of the former for the latter. Such problems are endemic to payment-by-results, as it used to be called, in the business sector, where painful lessons led many employers to abandon highly geared individual incentive schemes in the 1970s. It is important that such

lessons are taken into account in the design of incentive schemes in the education and training sector.

Output-related funding may entail some undesirable side effects. The first is concentration by providers on qualifications which are relatively cheap, such as those in services rather than engineering. The second is to reject pupils and trainees with special needs, who cost more to qualify. To minimise such problems, output-related payments need to take account of the benefit of the course, and include provisions for trainees with special needs, as appropriate.

A third problem is potential debasement of the qualification currency. NVQs – and, initially at least, GNVQs – are often assessed in public training by trainers and teachers whose incomes and job prospects may depend on a favourable result. The extent to which standards will be reduced by such incentives is a matter of controversy. No clear evidence has yet been produced of widespread abuse of the system. However, the risks are sufficiently clear to underline the importance of ensuring that the quality control systems run by bodies such as the NCVQ are effective, regularly monitored, and improved if they are shown to be failing.

Demand factors and externalities

In a well-functioning labour market, employers have incentives to adjust to skill shortages either through higher investment in training or through offering higher pay – thereby raising employees' incentives to invest in their own training. Some commentators have argued that persistent complaints of skill shortages suggest that such mechanisms have not worked well in the United Kingdom, resulting in a "low-skills equilibrium".⁷³ One explanation for such market failure is the possibility of "poaching" – firms may be unwilling to bear the costs of training workers if they think that the returns will be reaped by a rival firm. Proponents of the low-skills equilibrium also argue that firms adapt production techniques to the skills on offer, and may have limited use for an increased supply of skilled labour.

The inadequacy of the incentives to employers to offer occupational training when other employers can recruit their skilled workers has yet to be adequately addressed.⁷⁴ The obstacles to increasing employer training have been underlined recently by the slowness of progress towards national targets through work-based training and IIP certification (see above).

The recently introduced Modern Apprenticeship initiative may help overcome the externality problem in occupational training. It offers substantial public funds for craft and technician training, including shortened courses for 18 year old school-leavers, and extending to skills for which traditional apprenticeship never functioned. Employers' choices between training, "poaching" and deskilling work should gravitate over time towards training if the programme remains a priority. The programme should also require the complementary qualifications in technical education, along Industrial Training Board and German lines, which can be avoided under NVQs.

Equity

Increased reliance on market forces may increase economic inequality, either by aggravating existing inequalities or by creating new ones. At this point, it is difficult to assess the likely impact of the reforms on equity as different aspects point in different directions. On one hand, the greater investment in vocational educational services should benefit those students – including many coming from poorer households – who fared relatively poorly under the previous, more academically oriented system. On the other hand, the middle class may be better placed to take advantage of other aspects of reform. For example, decentralised, output-related funding may tend to reduce the access of disadvantaged agents to education and training. To the extent that providers are judged by gross outputs, such as exam results and NVQs, they may be encouraged to "skim the cream", *i.e.* select the more motivated and able pupils and trainees. For example, grant maintained schools typically pursue selective admission policies, which helps to raise their performance, as currently measured.

Some steps have been taken to reduce these risks, by relating funding to net rather than gross outputs, to allow for differences in backgrounds, and by increasing the funding provided for each disadvantaged participant, to allow for slower learning.⁷⁵ Such arrangements may, however, be undermined by intensified market forces, partly because of the incompleteness of measures of need, partly because of the increased priority given to exam grades and qualifications. There are no separate national targets for the disadvantaged.

Reverse causality also matters here: economic inequality in general hampers education and training reform. Income distribution has widened significantly since 1979.⁷⁶ High income inequality can act to constrain pupil achievements in

the lower tail of the distribution: learning can be a struggle for pupils from households which lack the resources to support their learning. The children of the working poor are under particular pressure to leave school as early as possible in order to bolster family income. Continued increases in educational participation and attainment may be difficult to achieve so long as inequality is high and/or rising in the wider economy.⁷⁷

Post-compulsory education

There are several key issues in post-compulsory education. For some of them, desirable directions of reform are evident. The first concerns the narrow range of subjects studied in general education after age 16. Sixth form (final year) students take at most four A-Level subjects, or distinct vocational courses, with no requirement to continue mathematics or language past 16, and considerable incentive for most not to do so (Wolf, 1992). Early specialisation reduces the cost of producing high subject-based standards at degree level, but that benefit imposes costs in other ways. A-Level courses are inappropriate for the middle third of academic achievers, who are turning increasingly to vocational courses anyway. They are also inappropriate for their own clientele of higher achievers, whose intellectual development is restricted by early specialisation. The partial curricular widening represented by one year Advanced Supplementary levels has amounted to little. Calls from a spectrum of educational, business and parliamentary representatives for the adoption of a multi-subject, 18-year old baccalaureate-type qualification have been rejected in favour of the "gold standard" of A-Levels.

The second issue concerns heavy public subsidisation of full-time university participants, which diverts public spending from other priorities such as part-time higher education, nursery schooling and occupational training, even though most participants could afford to pay more themselves, either from existing resources or by borrowing against future earnings. The government has started to tackle this anomaly by converting maintenance grants into loans, but progress has been slowed by opposition from predominantly middle and upper income beneficiaries.

Finally, policy remains divided over whether to support full-time education or part-time education and work-based training as sources of intermediate occupational skills. The merits of the two routes are disputed, by both social scientists

and the government departments identified with Education and Employment, respectively.⁷⁸ The issue may be resolved in practice by rising youth and employer preference for the full-time route, but Modern Apprenticeship should bolster the part-time one, following protracted neglect. It is likely that both routes will be kept and developed, perpetuating the United Kingdom's unusually mixed system, to the benefit of diversity and youth choice.

Adequacy of funding

Central control in education has been maintained through the Treasury's power over overall funding, in a political climate oriented towards cutting the share of government expenditure in GDP. Budgetary pressures on schools and universities have been only partly offset by increased income from private sources. Resource costs per pupil in state schools declined steadily relative to those in independent schools during the 1980s, standing at little more than one-half by 1990.⁷⁹

Restrictions on capital spending have adversely affected libraries, classrooms and equipment, particularly in science and technology. Underfunded institutions are poorly placed to deliver the more costly types of vocational and scientific education (e.g. in information technology and engineering), which diverts vocational secondary education in particular away from industrial areas, where intermediate skills are most in demand.⁸⁰

Prolonged fiscal restriction has been defended by government in terms of the scope for efficiency savings – which, for example, currently require a further 10 per cent cut in higher education costs during 1994-97, on top of the relatively severe fiscal squeeze applied during the past two decades (cf. Table 13). The scope for increased productive efficiency in education, particularly as it stood in 1979, is undeniable. However, it is not obvious how education can sustain rates of productivity growth comparable to those in industry. If the scope for raising productivity growth is limited, fiscal restriction can lead to allocative inefficiencies in the provision of public services:⁸¹ output levels inadequate relative both to customer and national needs. In education, as enrolments have risen strongly, it is the quality rather than the quantity of output that bears the brunt.⁸²

Conclusion

The balance of gains and losses in market-oriented reform cannot be drawn yet, while the more important reforms are still working their way through the system. The prospects are intrinsically mixed. The pursuit of financial gain will continue to harness considerable energy to the pursuit of national education and training goals. Government can in principle adapt the reforms in the light of their results – *e.g.* improving output measurements and acting against perverse incentives. On the other hand, increasing financial pressure on agents within underfunded quasi-markets can encourage opportunistic behaviour, to the detriment of professional commitment and quality standards. The net effects of these opposing tendencies remains to be seen. But, seen in historical perspective, recent reforms are yielding early results as manifested by greater post-compulsory participation in education and training, the rapid take-up of GNVQs and the prospective revitalisation of apprenticeship training.

The broad thrust of reform, in opening-up alternative routes to achieving labour market skills, is promising. This reorientation of policy should contribute progressively to improving the United Kingdom's stock of intermediate vocational skills in particular. A particularly promising development has been the rapid rise in post-16 year old staying-on rates. The reforms to the institutional structure, and in particular the opening up of the vocational route in upper secondary education would appear to have been an important catalyst, together with a more widespread appreciation of the value of education and training. Supply-side policies alone may not be sufficient to resolve the problem. This will also require business to upgrade their production techniques and demand for skills. But, if business continues to adapt to the increasingly more competitive international economic environment, and if the trend towards improved skills output is sustained, Britain's perceived deficiency in developing its human capital may now be on the way to being effectively addressed.

IV. Structural issues

Since the early 1980s, the United Kingdom has pursued structural reform on a broad front aimed at creating a more flexible and competitive economy. The previous chapter focused on reform in education and training. This chapter describes reform in other areas, notably the adoption of more active labour market programmes, and modifications in national insurance and benefit systems to improve the efficiency and flexibility of labour markets. This is followed by a brief update of progress in privatisation.

Labour market reforms

The UK labour market is one of the least regulated among EU and OECD countries, as far as restrictions on terms and conditions of employment and working time are concerned. But all workers are protected against discrimination on the basis of sex and race, and there is also a comprehensive framework of health and safety legislation. Employment protection legislation imposes relatively small hiring and firing costs,⁸³ and explains in part the relatively rapid adjustment in UK employment levels relative to changes in output,⁸⁴ compared with other OECD countries (see Chapter I). Rapid adjustment helps labour markets clear more efficiently, but can amplify cyclical swings.

A striking feature of UK work arrangements is the wide range of hours worked.⁸⁵ About a quarter of the work force is in part-time jobs. Part-time work is almost twice as prevalent as in France and is predominantly voluntary,⁸⁶ with around 45 per cent of female job-holders working part-time. To some extent, this trend has been encouraged by the rapid take-up of "in-work" benefits for families with dependents.⁸⁷

By March 1995, registered unemployment had fallen by some 630 000 from its late-1992 peak, raising concerns that skill shortages and wage pressures could

re-emerge in the coming few years. Estimates of the “natural rate” of unemployment vary widely, but most estimates place it above the 5.7 per cent actually recorded in 1990, when the economy was overheating.⁸⁸ OECD estimates place the natural rate in the 7 to 8 per cent range, with the short-run measure dropping to around 7 per cent in 1992.⁸⁹

The main reason why the “natural rate” is generally thought to be high in the United Kingdom (and elsewhere) is the large share of long-term unemployed despite economic recovery. In January 1995, over 900 000 persons had been unemployed for over a year, of which over 525 000 for over two years. The thrust of recent reforms has been to lower the natural rate through:

- targeting “active labour market policies” at the long-term unemployed;
- raising labour market skills of the labour force through better basic education, training and counselling (*cf.* Chapter III);
- modifying the benefit system to ensure that individuals are better off in-work than out of work;
- offering wage subsidies and hiring incentives for the long-term unemployed;
- and changing National Insurance Contributions to favour employment of the low paid, part-time and the long-term unemployed.

These initiatives are sketched out below.

Active labour market policies

The major concern with long-term unemployment, in addition to waste, is that individuals become increasingly detached from the labour force. The long-term unemployed become less hopeful of finding work, while employers become reluctant to hire them. The United Kingdom has launched several recent initiatives to increase labour market attachment of the unemployed.⁹⁰ Many of these are targeted at the long-term unemployed to reduce deadweight costs (*i.e.* subsidising actions which would have taken place in any case). The November 1994 budget announced:

- nation-wide extension of the “Workwise” and “1-2-1” schemes (which assist with job search for young people unemployed for over a year);
- extension of the “Community Action” scheme (which provides work experience for those unemployed for more than a year);

- expansion of the ‘‘Work Trials’’ scheme (which allows employers to take on those who have been unemployed for more than six months, on a three week trial period free of charge);
- nation-wide availability of the ‘‘Jobfinder’s Grant’’ (financial assistance averaging £200 a person to cover expenses incurred in taking a job, for those unemployed for more than two years);

Two new schemes will be tested in selected local areas:

- ‘‘Workstart’’ will provide wage subsidies to employers who recruit those unemployed for more than two years.
- ‘‘Jobmatch’’ will pay an allowance for six months to those unemployed for more than two years who take a part time job while continuing to look for full-time or additional part-time employment.

The net effects of these initiatives are difficult to estimate. However, their deadweight costs and displacement effects are likely to be small, and these measures should encourage greater labour market attachment and labour supply.

Employers’ national insurance contributions

The November 1994 budget also introduced changes to employers’ national insurance contributions (NICs), which will further favour employment of the part-time, the low paid and the long-term unemployed. From April 1996, employers will be exempted from NICs for up to a year, when hiring someone who has been unemployed for more than two years – it is expected that this will save employers £300 a year for each person hired. From April 1995 employer NICs will also be reduced by 0.6 per cent for employees earning less than £205 per week, adding to existing NIC incentives to hire part-time.⁹¹

The job-seeker’s allowance

The November 1993 budget foreshadowed far-reaching changes to the unemployment insurance system and a parallel tightening of invalidity benefit. These changes are expected to result in more intensive job search, reduced average spells of unemployment and greater labour supply.

In April 1996 unemployment benefit will be replaced by the Jobseeker’s Allowance (JSA).⁹² The JSA will consist of two elements:

- The first is a contributory element, which continues the principle of national insurance, with entitlement based on the claimant's previous contributions. But entitlement will be limited to 6 rather than 12 months, as at present.⁹³
- The second element is income-related. Persons not qualifying for the first JSA element will be eligible for an income-related payment, subject to a means test. This payment will be aligned with 'Income Support', which remains the minimal safety-net benefit.

Effective administration and counselling are critical elements in active labour market programmes. The JSA will facilitate the surveillance of availability-for-work requirements. Claimants will be interviewed regularly, and provided with guidance in jobsearch.⁹⁴ Where appropriate, claimants will be directed towards active labour market schemes (see above).

The new JSA should be more efficient to administer and it will be simpler to claim benefit. Previously, unemployment benefit and income support were administered by separate agencies, often in separate buildings. Under the new system, the Employment Service and benefits agency will work together to reduce administration and to provide a one-stop service. However, the thorny problem of moral hazard (*i.e.* that some individuals may choose not to seek work and choose to stay on with income support) remains unresolved.

Incapacity benefit

Between 1987 and 1994, the numbers claiming sickness and invalidity benefit rose sharply from 1.2 to 1.7 million, with a disproportionate rise for middle-aged and older men. To ensure better targeting on those genuinely incapable of work, Invalidity Benefit will be replaced by Incapacity Benefit from April 1995. The new scheme will apply a tougher medical test to assess incapacity and eligibility for benefit.

Benefits and work incentives

Social benefits are typically withdrawn at a rapid rate as earnings rise, to limit costs. In the early 1980s, marginal withdrawal rates in the United Kingdom could exceed 100 per cent, creating strong disincentives to work. This anomaly was tackled in 1988 by calculating entitlement on net rather than gross income.⁹⁵

No one faces marginal withdrawal rates of over 100 per cent, although 200 000 persons still had marginal withdrawal rates of over 80 per cent in 1993/94⁹⁶ (Table 24). An inherent problem with high social benefit withdrawal rates is that they produce strong disincentives to work. Modifications have been proposed to ease such problems (see below).

As of April 1996, the means-tested component of the JSA will replace "Income Support" as a safety-net benefit with a marginal withdrawal rate of 100 per cent. To counter the disincentive to take work and to encourage contact with the labour market, a "back-to-work bonus" will be introduced in October 1996. This will put 50 per cent of any earnings (while receiving benefit) towards a credit of up to £1 000, payable when the claimant moves into work of 16 or more hours a week. Those unemployed for longer than two years would also be eligible for the Jobfinder's grant (see above).

From July 1995, Family Credit and the Disability Working Allowance will offer an extra £10 a week to claimants working for more than 30 hours a week. This change will increase the incentives for recipients of Family Credit to work full-time rather than the 16 hours necessary to qualify for credit. Government projections indicate that some 345 000 people could benefit from this measure.

For childless households replacement ratios are low,⁹⁷ and will be further reduced when the "back-to-work bonus" is operational. Nevertheless a pilot project will begin in October 1996 to evaluate the effects of introducing an in-work benefit along the lines of Family Credit to childless households.⁹⁸

Table 24. **Number of people facing high marginal withdrawal rates on their earnings**

Thousand

	1985	1993-94
100 per cent and above	70	—
90 per cent and above	130	200
80 per cent and above	290	200
70 per cent and above	290	545
60 per cent and above	450	555
50 per cent and above	680	560

Source: Department of Social Security, *Departmental report*, 1994.

The Department of Social Security (DSS) has also announced measures to reduce temporary loss of social benefits when entering employment, including faster processing of Family Credit claims. Beginning in April 1996, recipients of Housing and Council Tax Benefit who have been unemployed for 6 months or more will maintain entitlement during the first four weeks after they take a job.

Housing benefit

Housing benefit is designed to assist those on low incomes with housing costs. It is means-tested and related to income and rent. Anyone receiving income support is entitled to housing benefit covering all of their rent. Above the income support level, the marginal withdrawal rate is 65 per cent of net income. But, when combined with tax, national insurance and other benefits, the marginal withdrawal rates on total gross income for recipients of housing benefit can be much higher.

Housing benefit per recipient has risen sharply in recent years, reflecting, in part, the pound for pound increase in benefit with the level of rents.⁹⁹ Benefit may be capped if rent exceeds local market levels. But this provision has not proved effective, especially when local rents are inflated by housing benefit guarantees. The DSS will tighten surveillance of local market conditions and cap benefit to contain costs. But concerns over costs must also take account of the need to provide adequate housing for low-income households.¹⁰⁰

State insurance of mortgages

Parallel measures have been taken to reduce state insurance of mortgages. Those qualifying for income support are entitled to state assistance with mortgage interest payments. From October 1995, new borrowers will no longer be eligible for assistance for the first nine months on income support.¹⁰¹ Private insurance is envisaged to cover interest payments during this nine-month period. For existing borrowers, no assistance will be given for mortgage interest for the first two months on income support, with one-half being paid for the next four months. After nine months on income support for new borrowers, (6 months for existing borrowers), mortgage interest on mortgages of less than £100 000 will be covered in full.¹⁰² These proposed modifications, as well as further reductions in mortgage interest tax relief, reduce the subsidies paid to those with mortgages,

and as such improve economic efficiency and ensure a more equitable fiscal treatment of homeowners and tenants. However, they may also have contributed to the continuing sluggishness of the housing market (see Chapter I).

Privatisation

Since 1979, the government has privatised almost 50 major businesses, with net proceeds expected to exceed £60 billion by the end of FY 1994/95. Recent sales have included Northern Ireland Electricity, British Coal, and nine of the ten subsidiaries of London Bus. Preparations are under way to privatise British Rail with much of the industry due to be sold over the next 18 months.¹⁰³ The government recently announced plans to privatise the nuclear power industry. The 1995/96 budget statement projects that privatisation proceeds will be £3 billion in 1995/96 and 1996/97 compared with £6¼ billion in 1994/95.

In addition to the privatisation programme, the ‘‘Private Finance Initiative’’ (PFI) is seeking to increase private sector participation in the provision of both capital assets and services in areas that had previously been restricted to the public sector. The government is in the process of putting out contracts under the PEI leading to around £5 billion of capital investment during 1995. These include the £2.7 billion Channel Tunnel Rail Link, a recently signed deal to provide a train service for the London Underground’s Northern Line, and the replacement of the National Insurance Recording System, one of the United Kingdom’s largest computer systems. In November 1994, the Chancellor announced that the Treasury will not approve any capital projects unless private finance options have been explored. Thus, the level of future investment under the Initiative could be substantial.¹⁰⁴

In summary, although more remains to be done if the productivity gap between the United Kingdom and its major trading partners is to be closed over the medium-term, the United Kingdom is among the pace setters with respect to microeconomic reform. All of the above structural measures are in the spirit of the OECD’s Jobs Study recommendations to improve the supply side of the economy and to lower unemployment durably.

V. Conclusions

The economic recovery in the United Kingdom which started in early 1992 gathered pace in the first half of 1994. Macroeconomic performance in 1994 was impressive on a broad front. Real GDP growth was 3.8 per cent, while the GDP deflator rose by just 2 per cent – the best output/inflation split since the mid-1960s. Unemployment dropped steadily for a second year. The current account moved into small surplus and the public-sector borrowing requirement (PSBR) narrowed sharply. These recent favourable outcomes suggest that the sweeping structural reforms launched in the 1980s are yielding dividends in a more flexible, competitive and less inflation-prone economy. Early action to reduce the PSBR and anticipatory increases in interest rates have been consistent with a stable medium-term policy framework conducive to sustained economic growth and low inflation.

GDP growth in 1994 was well above the estimated growth of potential output of some 2½ per cent, although it slowed in the second half of the year, due to lower public investment and stockbuilding. Large tax increases and a subdued housing market restricted the improvement in household balance-sheet positions, moderating the growth of consumer spending. Private investment continued to lag the cycle, despite above average capacity utilisation rates in manufacturing industry, good corporate cash flow and strong export order books. Net exports contributed around 0.6 percentage point to GDP growth in 1994, reflecting a competitive real exchange rate and buoyant export market growth. Import growth and market penetration were relatively moderate. The swing in the United Kingdom's current account into surplus in the second half of 1994 could be a milestone, as the unsustainability of previous expansions had often been reflected in a deterioration of the current balance.

A striking feature of this recovery has been the unusually early and rapid drop in unemployment, starting in December 1992. By March 1995, unemploy-

ment had dropped by some 630 000 to 2.3 million persons or 8.4 per cent of the labour force. The decline in unemployment was initially associated with a declining labour force, and the overall extent of unemployment decline is also in part a reflection of slow growth of the working-age population. But employment growth has also picked up more recently. Nominal and real wage moderation has also been marked and this has helped to “crowd-in” jobs, including full-time jobs starting in the summer of 1994.

Inflation has passed its cyclical trough, but there are few signs of emerging pressures stemming from skill shortages or excessive wage claims. Growth in average earnings in early 1995 was 3½ per cent, barely changed in over a year. Input prices have risen steeply, in line with the recovery in world commodity prices, but strong productivity gains have kept business cost positions under tight control. By April 1995, the 12-month rise in the Retail Price Index, excluding mortgage payments (RPIX) had picked up to 2.6 per cent (“headline RPI” was up 3.3 per cent), compared with a 27-year low of 2 per cent in September 1994. The rise in RPIY, which also excludes indirect taxes, was 2.1 per cent. Asset (and house) prices remain subdued. A still significant output gap, keen competition, and concerns about job security are containing inflation – and wages and employment appear to be adapting to a low-inflation environment and becoming more responsive to economic slack.

Sustained moderate private consumption growth is projected in 1995 and 1996, bolstered by a pick-up in full-time employment and higher earnings. Weak consumer confidence and a stagnant housing market could, however, limit any further decline in the household savings rate. Fiscal consolidation will further damp public consumption and investment. But business investment is expected to strengthen in response to better balance-sheet positions and good order books; and net exports are projected to contribute further to GDP growth in 1995-96 in response to strong cost competitiveness and the gathering pace of recovery in continental Europe.

GDP growth is projected at 3.4 and 3.0 per cent in 1995 and 1996, respectively, still above the growth of potential output, albeit slowing progressively as policy restraint bites. By end-1996, the UK economy could be experiencing the favourable situation of GDP growth slowing to a more sustainable rate, unemployment falling to close to its estimated natural rate – with inflation still moderate (in the 2.5 to 3 per cent range) and the current account near balance. The

PSBR should also be falling quickly to a sustainable medium-term level, preparing the ground for a “soft landing” of the economy.

The risks attached to these projections appear balanced. The main uncertainties concern the timing of the recovery in private investment and the degree of spare capacity in the economy – and their implications for inflation as the economy re-attains trend output. The generally favourable outlook is conditioned importantly by three features:

- i) lower inflation expectations,
- ii) the medium-term orientation of the macroeconomic policies in place and,
- iii) growing evidence of more flexible supply conditions.

Economic policy was tightened at a considerably earlier stage of the cycle than in past episodes. The two 1993 budgets (especially the one in March) were critical to this process. Significant fiscal consolidation was programmed to take effect in FY 1994/95 and 1995/96 – with the goal of reducing the PSBR from 7 per cent of GDP in FY 1993/94 to balance in the medium-term. By late 1994, with fiscal consolidation on track, the November 1994 budget adopted a neutral stance *vis-à-vis* the PSBR in FY 1995/96 and beyond.

The government’s fiscal objective is to bring the PSBR back to balance over the medium term (that is when the level of output is at trend). Programmed tax and spending measures are expected to reduce the structural budget deficit (as estimated by the OECD Secretariat) from 5½ per cent of GDP in 1993 to 1¾ per cent in 1996. Around two-thirds of this projected reduction is attributable to higher revenue and the rest to lower spending. Further expenditure restraint is programmed, with general government spending projected to fall from 42½ to 41 per cent of GDP, between FY 1995/96 and 1997/98. The ratio of gross general government debt to GDP rose to 48 per cent in 1994 and is projected to peak at 49 per cent in 1995, falling thereafter. The United Kingdom should satisfy the Maastricht criterion on budget deficits by FY 1996/97, and already meets the criterion on government debt. It is essential that the recent good progress towards medium-term fiscal consolidation is sustained; and that any tax and spending changes envisaged in the short-term are consistent with sound medium-term public finances.

Since September 1992, the monetary authorities have faced the challenge of filling the policy void left by sterling's suspension from the Exchange Rate Mechanism (ERM). The "new monetary policy framework" met this challenge. Its main feature is an explicit inflation objective – to maintain RPIX in the range of 1 to 4 per cent, and in the bottom half of that band by the end of the life of the current Parliament. The Bank of England is charged with making an independent, quarterly public assessment of inflation prospects two years ahead.

This framework has improved policy transparency and struck a balance between economic recovery and targeting low inflation. Base lending rates were raised pre-emptively by 50 basis points in September 1994 – when contemporaneous measures of RPIX were flat or falling – and subsequently raised in December and February to slow the excessive growth of demand. The September rate increase raised sterling and long-term bond prices, and the yield differential against German bonds fell by around 25 to 30 basis points through the last three months of 1994. The two subsequent base rate increases helped to stabilise UK long-term interest rates at around 8.3 per cent by early May 1995. But long-term differentials *vis-à-vis* the United States and Germany have changed little – possibly because the last two increases were anticipated by financial markets. Since September 1992, there has been a greater potential for monetary conditions to be affected by changes in sterling. Following an initial drop, sterling's effective rate remained in a narrow range until late 1994. But from end-1994 to early May it dropped by some 5 per cent. This weakness does not reflect economic fundamentals. To the extent that this fall is transitory, it would have few implications for underlying inflation. But, if sustained, it would represent a modest unplanned easing in monetary conditions.

The current inflation objective extends for the life of the Parliament, until May 1997 at the latest. As changes in interest rates have their maximum impact after one to two years, the objective will soon have to be updated if its forward-looking character is to be respected. An extension of inflation targets would be desirable, as they have worked well, are transparent and easily monitored. In doing so, the midpoint of the range should be lowered below its current 2½ per cent to build credibility. The medium-term target for inflation should ideally be below 2 per cent. To achieve the current inflation objective, short-term interest rates may have to be raised further in the coming year. Although interest rate

decisions are ultimately the responsibility of the Chancellor of the Exchequer, the new framework has strengthened the Bank of England's role in the policy debate, notably through the publication of the minutes of the monthly monetary meeting between the Chancellor and the Governor. These arrangements have reduced the scope for monetary policy to be driven by short-term political considerations. The positive experience with the current framework so far suggests that it can deliver the inflation objective. Credibility might be further enhanced by giving the Bank responsibility (possibly with legal backing) for determining the size and timing of interest rate changes. However, such changes would raise complex questions about Parliamentary accountability. Whatever the institutional framework, credibility will only be fully established by delivering sustained low inflation over a period of years.

It is clear that supply conditions in the United Kingdom have become more flexible, although it is difficult to quantify its extent. The OECD Secretariat estimates that the "natural rate" of unemployment declined significantly from the late 1980s to some 7 to 7½ per cent currently, resulting in an output gap of some 2 per cent of GDP in 1995. While unemployment has fallen significantly and at an earlier stage in the cycle, it is unclear whether the natural rate has fallen further. Recent labour market outcomes are, however, consistent with further modest falls in the natural rate and thus a somewhat higher output gap. The OECD Secretariat has tested for possible macroeconomic shifts in real wage and employment behaviour, and shifts in the regional dispersion of unemployment, since the 1980s. These tests suggest greater labour market flexibility, but as yet provide insufficient evidence to confirm a structural break in behaviour. But better wage and employment performance over the past several years are consistent with the cumulative effects of structural reform.

Long-term unemployment peaked at a lower level than in the previous cycle, but remains a serious problem. Despite a fall of over 150 000 persons in 1994, long-term unemployment (over 52 weeks) was still close to a million. Since the mid-1980s, government policy has shifted towards active labour-market measures to encourage labour-market attachment and labour supply. Policy has also aimed to enhance the financial incentives to work. Tax and benefit reforms have increased the gap between in-work and out-of-work net incomes, encouraged part-time and low-paid work and alleviated childcare costs of single-parent families. Pilot schemes including wage subsidies for the long-term unemployed and

work trial schemes are being launched. The present unemployment benefit will be replaced by a "Job Seekers Allowance" in April 1996, with the aim of speeding job search through a halving to six months of the benefit entitlement period (a means tested income support will still be available after six months). The orientation of such labour market programmes is positive and consistent with the policy recommendations in the OECD's Job Study. Their progress should be closely monitored for maximum impact on structural unemployment and to ensure cost effectiveness.

Labour market measure that have the effect of reducing structural unemployment can be expected to raise potential output in the medium-term. But a sustained rise in potential output growth and living standards also depends on progressively closing the productivity gap that still exists between the United Kingdom and its major trading partners, notably through raising the level of human capital skills. Prior to the 1980s, schooling failed to supply a good grounding in workplace skills, arguably trapping the UK economy into a "low skills equilibrium", and restricting the potential growth of productivity. Higher education for the elite was world class, but a majority of youth left compulsory education at age 16 with few or no formal qualifications for work. This problem was exacerbated by the lack of vocational training outlets, as well as the low esteem placed on vocational skills and training by business and society at large.

The wide-ranging reform of educational and training institutions launched in the 1980s sought to improve the efficiency and effectiveness of educational provision *via* the establishment of a quasi-market, a national curriculum, and a more effective vocational route after age 16. Such radical reform has inevitably encountered teething problems [*e.g.* the overly prescriptive nature of the original National Curriculum, the narrow design of some of the earlier National Vocational Qualifications (NVQs) and the over-lap of public and private objectives in the Training and Enterprise Councils' (TECs) first terms of reference]. These shortcomings are being addressed.

There is some evidence that these reforms are yielding better outcomes and efficiency gains. Post-16 year old staying-on rates have risen sharply, and at first degree level the United Kingdom's graduation rate is among the highest in Europe. The long-standing weakness in the provision of vocational education appears to have been addressed by the introduction of General NVQs and the

modern apprenticeship scheme. In particular, the rapid take-up of General NVQs suggests that they are meeting a previously unfulfilled demand. The development and increasing use of the Investors in People standard is a welcome sign of business commitment to training employees. Increased attention is also being given to encouraging lifetime learning.

While improved participation in post-16 education is welcome, it is important that quality standards are maintained, so that employers can use the qualifications obtained as reliable guides of potential employees' abilities. In particular, more needs to be done to ensure greater uniformity in National Vocational Qualification standards. It is important to ensure that standards are adequate regarding academic and vocational qualifications.

The adequacy of funding remains controversial in the United Kingdom as elsewhere. It is important to have measures of the ability of the system to meet the demands made of it. Existing measures include participation rates; non-completion rates; qualification rates; and marketability of qualifications. Additional indicators would be the ability to recruit and retain good quality staff; and educational access for the community as a whole. Where returns to education accrue largely to the individual (as in higher education), there is a case for a significant proportion of the cost to be borne by the student. However, some system may be needed to ensure that those from low-income families are not deterred from higher education on financial grounds.

Notwithstanding recent improvements, more needs to be done to ensure that the United Kingdom develops its human capital at least as well as its main competitors, particularly for 16-19 year olds. More effort is needed to gain public acceptance of and confidence in NVQs, and to develop the ethos of "life-time" learning. However, progress in these areas cannot be achieved by legislative measures alone. Families will have to raise the value they place on education and training, and more businesses need to view training as an investment rather than as a cost.

In conclusion, the stance of monetary and fiscal policies looks to be on course to sustain steady medium-term output growth and low inflation. The Medium Term Financial Strategy plots a clear path for fiscal consolidation, while the new monetary framework has facilitated a timely rise in interest rates at an early stage of the recovery. Sound medium-term macroeconomic policies are

necessary ingredients for transforming the United Kingdom's good structural reform record into higher sustained economic growth. On-going structural reform will enhance this process. Education and training where reform had lagged until recently are beginning to show promising results after initial teething problems. The further upgrading of the skill level of the United Kingdom's labour force and continuing microeconomic reform more generally should provide a sound basis for better medium-term performance of the economy.

Notes

1. A novelty in this recovery is the sharp break in "house price inflation" – with benefits for the overall economy. This probably reflects the recent experience of falling house prices, in a low inflation environment, as well as reform of the tax and benefit system which has further eroded the disproportionate advantages of home ownership relative to rentals (see Chapter IV).
2. Shifts in personal sector net wealth are strongly influenced by house prices. Net personal wealth hit a peak in 1989 relative to disposable income. In 1994 this ratio was down a fifth from its peak, but was still a third higher than in the early 1980s. In the second quarter of 1994, net financial wealth of households was £1 091 billion while the value of the housing stock less mortgage debt was estimated at £784 billion. Compared with 1989, these components represented a rise of 33 and a fall of 15 per cent respectively. It is difficult to assess what would represent "steady state" wealth to income ratios, especially with changing expectations concerning real house prices.
3. The Bank of England estimates that negative equity in housing amounted to around £5½ billion in the first quarter of 1995, and still affects 1.1 million households, see the Bank of England, *Inflation Report*, May 1995.
4. Most respondents to the CBI survey reply that investment is targeted at rationalisation and improving efficiency rather than increasing capacity. This is typical during recession and the early phases of recovery, but surprising in relation to the survey's own estimates of capacity utilisation and expected demand. This may of course reflect risk aversion or that the survey's estimates of capacity utilisation are flawed.
5. Including mining and quarrying, electricity and water and the manufacture of consumer, investment and intermediate goods.
6. See Barrell, R. and Sefton, J. (1995), "Output gaps, some evidence from the UK, France and Germany", *NIESR Review*, No. 151, pp. 65-73.
7. See Giorno *et al.* (1995).
8. The NAWRU is currently put at some 7 to 7½ per cent. This is a conservative estimate as recent calculations place it at 7 per cent, and structural measures in place (see Chapter IV) could lower it in the coming few years. The NAWRU is the key parameter in estimating the level of the output gap. The formulation of the production function adopted above makes potential output a linear transformation of the NAWRU.

9. Potential output is not exogenous, but can be affected by higher investment and other factors such as vigorous supply-side reform.
10. In the early 1970s, unemployment fell only from the third year of recovery; in the 1980s, it took five years of recovery before unemployment fell.
11. Survey evidence indicates that less than 10 per cent of employers in the United Kingdom consider insufficient flexibility in hiring and shedding labour as a serious impediment to employment, compared with over 20 per cent in France and Germany. See "Progress towards a flexible labour market" by Mark Beatson, *Employment Gazette*, February 1995. Original source European Commission, European Economy report, 1991.
12. Employment began to grow from March 1993 according to the Workforce in Employment (WIE) and spring 1993 according to the Labour Force Survey (LFS). However, the WIE showed falling employment in the first half of 1994, whereas the LFS continued to grow. As the WIE series is used in the construction of national accounts estimates, divergences between these data sources raise uncertainty concerning the evolution of household income and unit labour costs. These differences appear to have reflected sampling bias, with the WIE survey giving insufficient weight to small business (notably in construction), and registration lags in recording employment in new firms. Sample periods for the two surveys are also not strictly comparable. In March 1994, the WIE estimates for construction employees were revised back to September 1991. Both employee and self-employed estimates are based on LFS measures. The employee estimates now mirror the movements shown by the LFS, but at a lower level. By the third quarter of 1994, both series were indicating strong employment gains.
13. Winter 1994/95 LFS data show job creation concentrated in the banking, finance and insurance sector, in distribution, hotels and restaurants, and in other services. Employment fell in manufacturing and construction.
14. According to the LFS, total hours worked rose by around 2.0 per cent over the year to winter 1994/95, while total employment grew by 1.2 per cent. Real GDP was up around 4 per cent over the same period.
15. The April 1995 CBI survey reported that only 11 per cent of firms expected their output to be limited by a lack of skilled labour, compared with 28 per cent when the series peaked in October 1988. Skills mismatches appear less pronounced than in the late 1980s, with new hirings for skilled labour largely being met from the existing pool of unemployed. Reforms to improve the supply of skills should also have helped (see Chapter III), and frictional unemployment is lower, due to narrower regional differences in unemployment.
16. For a survey of the evidence, see Beatson, M., "Progress towards a flexible labour market", *Employment Gazette*, February 1995. This study finds little evidence of greater macroeconomic real wage flexibility. See also Barrell, R. (ed.), *The UK labour market: comparative aspects and institutional developments*, Cambridge University Press, 1994.
17. This paradox may reflect that:
 - i) reform was a necessary, but not sufficient, condition to improve macroeconomic performance. Minford and Riley (1994) argue that the rise in unemployment in the early 1990s was due to inappropriate macroeconomic policy. Anderton and Mayhew (1994) suggest that inadequate skills and training are to blame;

- ii) the reforms thus far have not touched yet on some central aspects of labour markets. Blanchflower and Freeman (1994) suggest that the "reform package failed to recognise the power of insider pressures for rent-sharing".
18. The hypothesis that there was no change in wage equation coefficients between the periods before and after 1982 cannot be rejected at the conventional 5 per cent level of statistical significance, but is close to being rejected at a 10 per cent level of confidence.
 19. But as above the changes between the two periods are not sufficiently large to confirm a structural break.
 20. This pattern is generally in line with estimates of the NAIRU (non-accelerating-inflation rate of unemployment). Cromb (1993) reports estimates ranging from 3.5 to 8.1 per cent for the period 1988 to 1990, down from a range of 5.2 to 9.9 per cent between 1981 and 1987. However, the wide range of such estimates calls into question their reliability.
 21. Under certain conditions, shifts in this relation can be taken as a proxy for the slope of the aggregate supply curve. This assumes that most shocks are nominal or demand side in nature. As the supply-curve is largely fixed in the short-run, the price/output split can be taken as a crude proxy of the slope of the supply curve. This indicator is ambiguous in the face of supply-side shocks, *e.g.* large increases in world oil prices, as the effects of the shock must be estimated.
 22. Fiscal years start 1 April.
 23. Small changes in the estimated growth of potential output and the output gap can have quite large effects on the structural deficit in the medium-term (*cf.* Chapter I). For details of the OECD's estimates see Giorno *et al.*, *ibid.*, 1994.
 24. The principal measures are to restrict tax relief on the married couple's allowance and on mortgage interest payments to 15 per cent from April 1995; increasing excise duties on road fuels and tobacco in real terms by 3 per cent and 5 per cent respectively; and a 3 per cent tax on insurance premiums from October 1994.
 25. There were also some savings from lower spending: in FY 1995/96 these were wholly due to the withdrawal of a scheme to help pensioners with the higher VAT on domestic fuel; in FY 1996/97 and 1997/98 the reserves in the public expenditure control total were reduced by around £300 million.
 26. The target is to hold "underlying" inflation (RPIX) in the range of 1 to 4 per cent, and in the bottom half of the target range by the end of the current Parliament (no later than mid-1997). Hence, the present operational target band is 1 to 2.5 per cent and not the widely cited 1 to 4 per cent range for RPIX.
 27. This appears to be partly due to spillover effects of the Deutschmark's strength *vis-à-vis* the dollar. International financial market uncertainty following the collapse of the Mexican peso, appears to have triggered a global reassessment of foreign exchange rates and sovereign risk.
 28. Slow growth of M4 largely reflects private sector balance sheet restructuring and a shift away from bank and building society intermediation (*cf.* Chapter I). Private sector agents have used income that they might otherwise have spent to repay debt, thereby depressing M4 growth.

29. For example see Taylor (1985).
30. Englander and Gurney (1994) estimate that labour productivity in the business sector in the United Kingdom in 1990 was more than 10 per cent lower than in the United States, France, Canada, Germany and Italy, but higher than in Japan.
31. Keep and Mayhew (1995) describe a low-skills equilibrium, in which employers organise their working practices to accommodate a low-skilled workforce, while individuals perceive limited returns to acquiring skills, preferring to offer the low skills demanded by employers.
32. Differences between education and training institutions in England and Wales, on the one hand, and Scotland and Northern Ireland, on the other, are largely elided. The discussion refers to England and Wales in cases of divergent practice, but much applies to the remainder of the country as well. The main intra-UK differences involve education, where Scotland operates a broader secondary curriculum and Northern Ireland retains a selective secondary system. Each system is run by a single UK government department responsible for training programmes as well (National Commission on Education, 1993). Education in Northern Ireland was brought into a single system by legislation passed in 1923, under which local government took over responsibility for its administration, supervised by the Ministry of Education. For further details see Britain 1995, HMSO.
33. There are arguments for both approaches. The United Kingdom system enables students to study individual subjects at greater depth, but the range of subjects studied is narrower, forcing students to make an earlier choice of which subjects to pursue further.
34. See OECD (1993), *Education at a glance*, Tables R2 and R3.
35. OECD (1993), *Education at a glance*, Table R7.
36. See OECD (1993), *Employment Outlook*; Gregg and Machin (1994).
37. Department of Education and Science, 1988.
38. Bennett *et al.* (1992).
39. Gregg and Machin (1994). Similarly, rapid growth of new full-time vocational qualifications weakens the relevance of findings based on the set which had been available to the workforce of the early 1980s (Green, 1994).
40. See Romer (1990).
41. See Weale (1993).
42. High rates of displacement of regular trainees and employees have been found by studies of work-based public training programmes (Begg *et al.*, 1990, and Deakin, 1995).
43. See Prais (1989).
44. See, for example, Steedman and Wagner (1988).
45. Shackleton (1992), Chapman (1993).
46. O'Mahony (1992), Oulton (1995). Plant-level international comparisons do not invariably suggest economic losses as a result of lower skill inputs. Labour productivity is similar in British and German chemicals notwithstanding a gap in employee qualifications at intermediate level similar to that in other sectors (Robinson, 1994).
47. Glennerster (1991), Le Grand and Bartlett (1993), Finegold (1995), Ryan (1995).

48. The Skillcentres which in 1979 provided off-the-job occupational training, primarily at craft level to the unemployed and to female re-entrants, were initially required to seek private funding by selling unsubsidised training to employers. The move to work-based adult training after 1986 reduced government demand for their courses. Centres which lost money on increasingly commercial criteria were closed. The remaining ones were grouped into the Skills Training Agency, which was privatised in 1990.
49. Smithers and Robinson (1991).
50. *Financial Times*, 11 November 1994. For details, see Department for Education (1995).
51. The previous qualifications system was fragmented and incomplete. The new system of NVQs provides opportunities to progress from lower to higher levels and for movement between skill areas. They also extend the qualifications into occupations which were not adequately covered previously.
52. See Hirsch (1994).
53. Garonna and Ryan (1991).
54. Employment Department, Skills and Enterprise Executive, November 1994.
55. Ryan (1991, 1995a), Payne (1994).
56. Tax relief is a misnomer for a subsidy which is available to non-taxpayers as well (Pratten and Ryan, 1994).
57. *Financial Times*, 13 July 1994.
58. The Scottish equivalent is the Local Enterprise Company, which is charged with wider economic development functions than its southern counterpart (Bennett *et al.*, 1994; Bennett, 1994).
59. Employment Department, Skills and Enterprise Executive, August 1994.
60. Department for Education, Statistical Bulletin, No. 10/94, July 1994.
61. The move towards increased post-16 participation may have originated in greater awareness of the benefits of obtaining further qualifications, together with greater confidence gained from the new GCSE qualifications, which allowed competences to be assessed by course work as well as by written examinations.
62. *Financial Times*, 31 August 1994.
63. Employment Department, Labour Market Quarterly Report, August 1994; Green and Felstead (1995).
64. For example, retailers rejected the original set of NVQs for their industry as being inappropriate and too narrow. But after consultation and adaptation, large retailers are backing the system. By contrast, the original NVQs for the mechanical engineering sector were well designed and quickly gained acceptance.
65. In 1993/94, 71 per cent of trainees completing training under YT had gained a full or part qualification, and in 1992/93 70 per cent of those gaining a full qualification had achieved NVQ Level II or above, compared with 37 per cent in 1990/91.

66. National Council for Vocational Qualifications, NVQ Monitor, Autumn 1994; Department for Education (1994), Table 35; Steedman and Wagner (1988); Payne (1994); Green and Felstead (1995).
67. Department of Employment, Skills and Enterprise Executive, September 1994; *Financial Times*, 6 June 1994.
68. Marsden and Ryan (1990, 1991); Ryan (1995b).
69. *The Times Educational Supplement*, 2 September 1994.
70. For example, the criterion "employer commitment to IIP", for which TECs are rewarded, can be satisfied by commitments which vary from the serious to the procrastinatory, but the data cannot indicate which applies in practice. Similarly, it has proved difficult to find objective indicators to which performance-related pay for headteachers can be tied.
71. See Jessup (1991), Prais (1991), Smithers (1993), Steedman (1992), Further Education Funding Council (1994).
72. The Curriculum, Education and Management Centre at Newcastle University have produced net output (or value added) measures of A-level results for over a decade, (Fitzgibbon 1994).
73. Keep and Mayhew (1995); Finegold and Soskice (1988).
74. Stevens (1994), Marsden and Ryan (1991).
75. The needs of the disadvantaged pupil and trainee have been catered to in various ways. Payments made to schools under formula funding depend on indices of local social deprivation. Under LMS, LEAs retain 15 per cent of their budgets to fund special needs teaching, inter alia. Additional funding is provided in YT and YC for disadvantaged youths with "endorsed" status, who enjoy least access to employer-sponsored training. TECs are rewarded for ensuring that unemployed young people, including the hard to place, are offered a YT/YC place within eight weeks.
76. Atkinson, Rainwater and Smeeding (1994), Prais (1993).
77. An adverse role for inequality, rather than simply absolute living standards, has been established for public health in the United Kingdom and economic performance in the United States (Glyn and Miliband, 1994; "Inequality: how the gap between rich and poor hurts the economy", *Business Week*, 15 August 1994).
78. Marsden and Ryan (1990), Soskice (1993).
79. National Commission for Education (1993), Figure 14.2.
80. The emerging scope for universities to raise funds from capital markets may relax the squeeze on capital account for those with increasing income from private sources (*Financial Times*, 20 June 1994).
81. The government's relationships with schools, universities and TECs are close to monopolistic, allowing it to under-reward inputs, to the detriment of teacher quality in particular.
82. Ryan (1992). Universities award their own degrees with only limited external monitoring and concern that teaching and degree standards may be declining has been voiced even in government circles (*Financial Times*, 26 September 1994).
83. See OECD (1994), *Jobs Study: Evidence and Explanations*, Part II, pp. 70-73.

84. Overall swings in employment in the United Kingdom are more pronounced than for countries of similar size, such as France or Italy. UK total employment fell by 1.6 million between 1979 and 1983 and rose by 3.2 million between 1983 and 1990. Between 1990 and 1993, it fell by 1.8 million. Since Winter 1992-93, employment has started to increase again with an increase of 0.4 million by Autumn 1994.
85. The distribution of hours worked tends to be relatively flat with clusters around 16 hours (the minimum to qualify for Family Credit) and 40 hours a week.
86. Only 13 per cent of part-timers were searching a full-time job in late 1994. See Naylor (1994).
87. Currently, 580 000 families receive Family Credit. This is an in-work benefit for families with dependent children, for which at least one adult works a minimum of 16 hours a week. See below for more detail.
88. A representative estimate is Barrell *et al.* (1994) who indicate a NAIRU for the United Kingdom in the range of 7 to 8 per cent. Ireland *et al.* (1995) estimate the natural rate at 6 per cent. By contrast, Minford and Riley estimate the long-run NAIRU at below 1 million in 1993.
89. See Turner and Rauffet (1994). These estimates overpredict wage increases in the post-1992 sterling devaluation period. This would be consistent with a further small drop in the "natural rate", but the evidence is not conclusive.
90. The Restart Programme is, for example, generally credited to have reduced the duration of unemployment and increased training. For an assessment of active labour market policies, see Chapter 6 of "The OECD Jobs Study: evidence and explanations", OECD (1994), and D. Grubb (1994).
91. From April 1995, employers' NICs for an employee earning £240 per week will be £24.48 a week. If the job is split into two part-time jobs each paying £120 a week, total NICs fall to £12; if split into three jobs paying £80 a week, NICs fall to £7.20.
92. A detailed description of the new benefit can be found in the White Paper, "Jobseeker's Allowance", Cm2687, HMSO, London.
93. Entitlement periods must allow time to match diverse job demands and skills efficiently. But excessively long or open-ended periods tend to raise unemployment and social dependency. Studies in Canada (where benefit periods can vary between Provinces) and elsewhere show that job search is most intense at the end of entitlement periods, regardless of its length. Hence, cutting them judiciously would reduce the average duration of unemployment, notably for females with weaker labour force attachment. How long a benefit period is adequate is difficult to judge. In Canada this tends to vary with the cycle and local labour market conditions, often resulting in perverse effects on incentives, see OECD, *Economic Survey of Canada 1993/94*, Annex I.
94. The JSA contains an "Employment on Trial" provision, which will encourage trying unfamiliar jobs. This provision will allow those unemployed for over 13 weeks, to take a job for a trial period, while maintaining benefit entitlement if they leave voluntarily. Benefits are usually not paid for up to 26 weeks to voluntary job quitters. This new provision is conditional on having tried the new job for at least 6 weeks, but for less than 12 weeks.

95. Where a claimant is entitled to two or more benefits, entitlement to the first is taken into consideration in assessing entitlement to additional benefits.
96. Very high marginal withdrawal rates can apply to households with dependents, because income support includes allowances for children. In the absence of "Family Credit", the marginal net withdrawal rate – including tax, national insurance and other benefits can be close to 70 per cent. Marginal gross withdrawal rates are higher: around 80 per cent for a recipient of family credit, paying income tax and National Insurance, or for those also receiving housing benefit.
97. In 1993, the replacement ratio for a single man without children who had the possibility of working 30 hours a week at half median hourly earnings was 40 per cent; for a married man 63 per cent; for a single woman 50 per cent; for a married woman 79 per cent.
98. This pilot project may yield quite small effects on labour market participation due to its diffused nature. A partial simulation by the Institute of Fiscal Studies (IFS) suggests that the main beneficiaries of such an extension of Family Credit would be young, single people, mainly living with their parents and enjoying relatively high household living standards. Better targeting would reduce deadweight costs. For example, the IFS suggest limiting the scheme to those aged over 25. The simulation is partial in that no attempt is made to model the increased labour supply that the reform might promote. See IFS (1994).
99. Between 1988/89 and 1992/93 spending on rent rebates and rent allowances increased from £3.8 billion to £7.6 billion, while the number of recipients rose from 4.1 million to 4.3 million.
100. In 1992-93, 1.3 million households were receiving housing benefit for accommodation rented from the private sector, while official figures show that 134 000 households were homeless in 1993 in England alone. See *Britain 1995: An Official Handbook*, HMSO, London. Table 21.2.
101. There will be special arrangements for the sick, disabled and lone parents.
102. Until August 1993, there were no limits on the maximum size of loan covered. In general, those who become unemployed with large mortgages do not qualify for income support. Nonetheless, in 1993, around 5 000 people received interest payments of over £200 per week, roughly equivalent to a loan of £130 000. Such loans greatly exceed average house prices which peaked in 1989 at around £66 000 nation-wide, and £94 000 in the Greater London region.
103. British Rail is being split into different companies. Of these, Railtrack will own and manage stations, track and signalling; rolling stock will be owned by three leasing companies; passenger services will be franchised to some twenty-five operating companies; freight and parcels services are expected to be sold outright, as are companies responsible for the maintenance of track and rolling stock.
104. As of 31 December 1994, 64 projects worth £0.5 billion had been finalised, 26 projects worth £4.3 billion were out to tender, and 595 projects worth £16 billion were in pre-tender stages. Of the projects finalised, 52 were worth less than £5 million, and 12 worth between £5 million and £25 million. Two-thirds of these were concluded by the Department of Health.

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Annex I

Changes in labour market behaviour

This annex reports econometric evidence on whether there has been a change in labour market behaviour, at the macroeconomic level. A regression for wage behaviour suggests that real wages have become more flexible in the first two years following a shock to either productivity or price levels. A second regression indicates that levels of employment have become more sensitive to the level of real wages. Taken together, these results are supportive of greater flexibility in the labour market in recent years, but since neither result is statistically significant at the conventional 5 per cent significance level, the evidence is not conclusive.

Wage regression

In the wage regression, wage-rates are related to consumer price inflation, productivity, and unemployment (Table A1). Labour market slack is measured as the difference between actual and trend unemployment, (trend unemployment acts as a proxy for the natural rate). The long-run solution to the regression implies that real wages grow in line with productivity. The speed of adjustment towards the long-run solution is determined by the coefficients on the long-run solution and on lagged wage growth.

Table A2 reports the response of nominal wages to changes in productivity, consumer price inflation and unemployment implied by the regressions for two subperiods. The principal changes are in the speed of response of real wages to changes in the level of productivity and prices. The response of wages to productivity changes was more rapid in the 1980s than in the 1970s, while nominal wages responded less rapidly to an increase in the price level. Both these changes imply greater short-term flexibility in real wages. By contrast, the response of wages to deviations of unemployment from trend was little changed between the two periods.

The hypothesis that there was no change in the regression coefficients between these two periods is not rejected at the conventional 5 per cent significance level, but is rejected at a weaker 15 per cent significance level. There are two possible ways of interpreting this result:

- a strict interpretation would take insignificance at the 5 per cent level to indicate that no structural change has occurred;

Table A1. Wage regressions¹
Dependent variable: growth of wage-rate

Explanatory variable	1971-82		1983-94	
	Coefficient	T-ratio	Coefficient	T-ratio
Constant	-0.1739	2.1	-0.1383	4.0
Growth of wage-rate (-1)	0.3215	2.4	0.1235	0.8
Growth of productivity	0.4217	1.9	0.7293	4.6
Growth of consumer prices	0.3945	2.6	0.2461	1.0
Unemployment gap (-1)	-0.0070	2.6	-0.0072	5.6
Logarithm (Real wages/productivity) (-1)	-0.2622	2.5	-0.2106	4.6
Dummy variable	0.0588	2.6		
Regression standard error	0.0098		0.0059	

1. Regression estimated using semi-annual data.

Wage-rate defined as total wages and salaries divided by total employment.

Productivity defined as real GDP divided by total employment.

Unemployment gap defined as difference between the unemployment-rate and its trend (17 semester centred moving average).

Dummy variable takes value 1 in 1974:2 and 1975:1.

Growth of a variable calculated as a change in its logarithm.

The differences in regression coefficients between the two sub-periods are jointly significant at an 11 per cent significance level.

Source: OECD.

Table A.2. Wage responses¹

Half years after shock	Response of nominal wage (per cent) following:					
	Price level increase		Productivity increase		Unemployment increase	
	1971-82	1983-94	1971-82	1983-94	1971-82	1983-94
0	0.39	0.25	0.42	0.73	0.00	0.00
1	0.68	0.44	0.71	0.88	-0.70	-0.72
2	0.86	0.58	0.88	0.92	-1.43	-1.39
3	0.95	0.68	0.96	0.94	-2.00	-1.90
4	0.99	0.76	1.00	0.96	-2.34	-2.23

1. Responses derived from regressions reported in Table A1.

Table shows response of nominal wages to:

a) a 1 per cent increase in the price level

b) a 1 per cent increase in the level of productivity

c) a 1 percentage point increase in the unemployment rate.

Source: OECD.

- an alternative interpretation is that the results are suggestive of a change, but are not sufficiently robust to be conclusive;

Employment regression

The regression for employment relates total employment to the levels of output and real wages (Table A3). In the 1971-82 period, the estimated response of employment to real wages was positive, albeit not statistically significant. In contrast, in the 1983-94 period there is a statistically significant negative response, which implies that each 1 percentage point fall in real wages raised employment levels by 0.6 percentage point in the long-run. The equation also suggests that employment levels were less immediately responsive to changes in GDP in the 1980s. The hypothesis that the regression coefficients did not change between the two periods cannot be rejected at the conventional 5 per cent significance level, but is rejected at the 10 per cent level.

Table A3. **Employment regressions**¹

Dependent variable: growth of employment

Explanatory variable	1971-82		1983-94	
	Coefficient	T-ratio	Coefficient	T-ratio
Constant	-3.227	5.6	-3.330	3.4
Growth of real GDP	0.301	5.8	-0.022	0.2
Logarithm of productivity (-1)	-0.340	5.6	-0.334	3.1
Real wage gap (-1)	0.014	0.4	-0.189	2.0
Time trend	-0.0031	6.2	-0.0028	2.5
Regression standard error	0.0040		0.0046	

1. Regression estimated using semi-annual data.

Productivity defined as real GDP divided by total employment.

Real wage gap calculated as the logarithm of real wages minus the logarithm of productivity.

Wage-rate defined as total wages and salaries divided by total employment.

Growth of a variable calculated as change in its logarithm.

The differences in regression coefficients between the two sub-periods are jointly significant at a 10 per cent significance level.

Source: OECD.

Annex II

Calendar of main economic events

1993

January

The base rate is cut to 6 per cent.

February

Wide range of public spending reviews launched to question the basic principles of the welfare state.

March

PSBR forecast to reach £50 billion in 1993/94. Tax measures include VAT on domestic fuel, mortgage relief to be restricted to 20 per cent from April 1994. Most excise duties raised by 5 per cent.

May

Kenneth Clarke replaces Normant Lamont as Chancellor of the Exchequer.

June

UK cabinet sets toughest public spending limits in 15 years.

August

All ERM currencies except guilder and deutschemark to have wider bands of 15 per cent, following exchange market turmoil.

November

The base rate is cut to 5½ per cent in advance of the budget.

The first unified budget reduces mortgage interest relief to 15 per cent by 1995/96. Tax allowances are frozen. A freeze on public sector running costs was introduced until 1997 as part of a cut in public spending. Student grants are cut by 10 per cent. PSBR to be brought to zero in the medium-term.

1994

February

The Bank of England reduces base rates by 0.25 percentage point to 5.25 per cent.

April

Domestic fuel becomes subject to value added tax at 8 per cent. PSBR outcome for FY 1993/94 of £45.9 billion ($7\frac{1}{4}$ per cent of GDP).

June

European Court of Justice rules that employment laws in the United Kingdom do not comply with European laws regarding provision for consultation between employees and employers.

July

Tony Blair elected leader of the Labour Party.

September

Bank of England increases base lending rate by 0.5 per cent to 5.75 per cent. First base rate increase since 1989.

United Kingdom opts out of European Union policy to extend paternity rights and employee representation on company decision-making bodies.

RPIX (retail prices less mortgage interest payments) annual inflation rate reaches trough of 2 per cent – lowest level for 27 years.

November

Budget for FY 1995/96 presented to Parliament:

- public sector borrowing forecast to be £34.5 billion in 1994/95, £21.5 billion in 1995/96, falling to zero by 1998/99;
- government spending to be under strict control: real growth of general government spending excluding privatisation proceeds to be 0.1 per cent in FY 1995/96, 1.1 per cent in FY 1996/97, 0.7 per cent in FY 1997/98;
- measures targeted at reducing unemployment include: reduction in national insurance contributions for low paid; subsidies to employers for hiring those unemployed for over two years; expansion of a number of active labour market programmes (Work Trials, Workstart, 1-2-1, Workwise); piloting of an in-work benefit for childless couples and single people to begin in October 1996.

December

Parliament defeats proposal to increase value added tax on domestic fuel to 17.5 per cent in April 1995. Excise duties are raised to compensate for the loss of revenue.

Bank of England increases base lending rate by 0.5 per cent to 6.25 per cent.

1995**January**

Privatisation of British Coal.

February

Bank of England increases base lending rate by 0.5 per cent to 6.75 per cent.

STATISTICAL ANNEX AND STRUCTURAL INDICATORS

Table A. Expenditure on GDP

£ million

	GDP at factor cost (expenditure-based)	Total expenditure at market prices	Total domestic demand	Consumers' expenditure	Public current expenditure	Fixed investment	Change in stocks	Exports of goods and services	Imports of goods and services	Indirect taxes less subsidies
At current prices										
1985	307 902	456 332	354 291	217 485	75 267	60 718	821	102 041	98 988	49 442
1986	328 272	486 064	388 179	241 554	80 911	65 032	682	97 885	101 221	56 571
1987	360 675	535 118	428 721	265 290	87 045	75 158	1 228	106 397	111 737	62 706
1988	401 428	596 226	488 953	299 449	93 641	91 530	4 333	107 273	124 796	70 002
1989	441 759	658 765	537 279	327 363	101 796	105 443	2 677	121 486	142 808	74 198
1990	478 886	699 403	566 238	347 527	112 934	107 577	-1 800	133 165	148 285	72 232
1991	495 900	716 131	581 897	364 972	124 105	97 747	-4 927	134 234	140 810	79 421
1992	516 027	746 613	606 136	382 240	131 886	93 942	-1 932	140 477	149 492	81 094
1993	546 589	798 048	639 716	406 488	138 710	94 715	-197	158 332	166 513	84 946
1994	578 300	847 923	674 066	427 521	144 393	99 011	3 141	173 857	179 625	89 998
At 1990 prices										
1985	407 844	573 567	464 404	276 742	105 097	81 575	990	109 163	105 957	59 766
1986	424 214	601 377	487 330	295 622	106 824	83 685	1 199	114 047	113 255	63 908
1987	443 817	633 690	513 083	311 234	107 858	92 339	1 652	120 607	122 075	67 798
1988	465 746	674 658	553 461	334 591	108 612	105 164	5 094	121 197	137 443	71 469
1989	476 228	696 555	569 719	345 406	110 139	111 470	2 704	126 836	147 615	72 712
1990	478 886	699 403	566 238	347 527	112 934	107 577	-1 800	133 165	148 285	72 232
1991	468 913	680 715	548 532	339 915	115 845	97 403	-4 631	132 183	140 407	71 395
1992	466 564	686 684	550 371	339 946	115 842	96 280	-1 697	136 313	149 131	70 989
1993	476 423	703 446	562 647	349 273	116 948	96 611	-185	140 799	153 368	73 655
1994	495 066	732 860	579 471	358 370	118 805	99 679	2 617	153 389	162 390	75 404
Seasonally adjusted										
1994 1	121 726	180 714	144 001	89 086	29 541	25 062	312	36 713	40 475	18 513
2	123 388	182 012	144 317	89 240	29 678	24 741	658	37 695	39 671	18 953
3	124 501	183 353	144 371	89 645	29 744	24 667	315	38 982	39 905	18 947
4	125 451	186 781	146 782	90 399	29 842	25 209	1 332	39 999	42 339	18 991

Source: Central Statistical Office, *Economic Trends*.

Table B. Gross domestic fixed capital formation

£ million

	Total	Private sector ¹	General Government ¹	Public corporations ¹	Vehicles, ships and aircraft	Plant and machinery	Dwellings		Other new building and works ²	Energy and water supply	Manufacturing
							Private	Public			
At current prices											
1985	60 718	47 915	6 872	5 931	6 439	23 870	9 683	2 536	18 190	2 660	10 283
1986	65 032	52 002	7 509	5 521	6 222	24 690	11 526	2 614	19 980	2 792	10 105
1987	75 158	63 020	7 577	4 561	7 805	27 073	13 439	2 916	23 925	2 798	11 040
1988	91 530	80 444	6 506	4 580	8 849	31 504	18 013	2 914	30 250	3 119	12 415
1989	105 443	90 394	9 582	5 467	10 324	36 382	19 142	3 846	35 749	3 943	14 248
1990	107 577	89 963	12 659	4 955	10 266	36 762	17 212	4 227	39 110	4 742	14 227
1991	97 747	81 825	12 143	3 779	8 647	34 677	15 681	2 820	35 922	5 608	13 183
1992	93 942	76 874	12 440	4 628	8 957	34 156	16 108	2 584	32 137	6 331	12 163
1993	94 715	78 568	11 097	5 050	10 056	35 579	16 725	2 742	29 613	6 084	12 165
1994	99 011	81 452	12 395	5 164	10 567	37 894	18 259	2 678	29 613	5 397	12 686
At 1990 prices											
1985	81 575	65 820	8 441	7 277	9 480	27 081	14 899	3 489	26 486	3 334	12 710
1986	83 685	67 877	9 163	6 645	8 493	27 512	16 681	3 489	27 510	3 404	12 097
1987	92 339	78 092	9 027	5 220	9 846	29 086	18 036	3 771	31 600	3 304	12 641
1988	105 164	92 481	7 579	5 104	10 372	33 770	21 741	3 506	35 775	3 490	13 846
1989	111 470	95 745	10 054	5 671	11 231	37 925	20 653	4 136	37 525	4 094	14 984
1990	107 577	89 964	12 659	4 954	10 266	36 762	17 212	4 227	39 110	4 742	14 227
1991	97 403	80 896	12 643	3 864	8 008	33 955	15 083	2 836	37 521	5 612	12 803
1992	96 280	77 970	13 545	4 765	7 960	32 888	15 524	2 756	37 152	6 501	11 590
1993	96 611	78 189	13 036	5 386	8 611	32 895	16 184	3 054	35 867	6 211	10 989
1994	99 679	79 429	14 690	5 560	8 986	34 338	17 223	2 919	36 213	5 483	11 239
Seasonally adjusted											
1994 1	25 062	19 095	4 572	1 395	2 175	8 322	4 312	868	9 385	1 446	2 695
2	24 741	20 218	3 241	1 282	2 223	8 559	4 368	669	8 922	1 470	2 774
3	24 667	19 811	3 475	1 381	2 227	8 630	4 138	688	8 984	1 338	2 823
4	25 209	20 305	3 402	1 502	2 361	8 827	4 405	694	8 922	1 229	2 947

1. Including purchases less sales of land and existing buildings.

2. Including transfer costs of land and buildings.

Source: Central Statistical Office, *Economic Trends*.

Table C. Household appropriation account

£ billion

	Compensation of employees	Property and income	Transfers received	Gross total income	Direct taxes	Social security contributions	Other current deductions ¹	Disposable income	Private consumption	Personal savings ratio ²	Real income ³
1985	196.9	64.9	45.4	307.1	37.8	24.2	1.7	243.5	217.5	10.7	3.4
1986	212.4	71.6	49.5	333.4	40.8	26.2	1.9	264.5	241.6	8.7	4.5
1987	229.8	79.0	50.8	359.7	43.5	28.6	2.1	285.4	265.3	7.1	3.4
1988	255.6	92.6	52.2	400.4	48.3	32.1	2.3	317.7	299.4	5.7	6.0
1989	283.5	104.9	54.0	442.4	53.6	32.9	3.0	352.9	327.4	7.2	4.9
1990	312.4	115.4	58.9	486.7	61.5	34.7	11.2	379.3	347.5	8.4	1.9
1991	329.6	119.5	69.3	518.4	63.4	36.4	10.8	407.8	365.0	10.5	0.1
1992	342.2	129.2	80.1	551.5	65.2	37.2	10.6	438.5	382.2	12.8	2.7
1993	352.7	132.2	88.8	573.7	63.8	38.8	10.9	460.3	406.5	11.7	1.4
1994	365.3	140.9	92.8	599.0	68.5	42.0	11.2	477.3	427.5	10.4	1.2
Seasonally adjusted											
1994 1	90.8	33.0	23.3	147.1	16.5	10.2	2.7	117.7	105.2	10.6	1.0
2	90.5	34.5	22.9	147.9	16.7	10.2	2.8	118.1	106.1	10.2	0.4
3	91.3	36.5	23.0	150.8	17.6	10.4	2.8	120.0	107.3	10.6	1.8
4	92.6	37.0	23.5	153.2	17.7	11.2	2.8	121.4	108.9	10.3	1.4

1. This series includes other current transfers and from 2nd quarter 1989, payments of the community charge.

2. As a percentage of disposable income.

3. Percentage change.

Source: Central Statistical Office, *Economic Trends*.

Table D. **Consumption and investment**
Seasonally adjusted

	Consumer demand				Investment					
	Retail sales		New car registrations	Changes in hire purchase debt total	Capital expenditure of		Engineering new domestic orders ¹	Housings starts		Investment in stocks (manufacturing)
	Total	Non-food			Manufacturing industry	Other industries		Private	Public	
	Volume 1990 = 100		Thousand, monthly averages	£ million, end of period	£ million at 1990 prices		Average monthly sales 1990 = 100	Thousand		£ million at 1990 prices
1985	82.8	78.2	154	2 309	12 710	36 361	72	165.7	34.5	-612
1986	87.2	83.7	157	2 385	12 097	37 904	77	180.1	33.5	-686
1987	91.6	89.5	168	3 498	12 641	44 692	76	196.8	32.8	-486
1988	97.3	96.9	184	3 639	13 846	51 981	102	221.7	30.9	992
1989	99.2	99.3	192	3 248	14 984	58 632	107	169.9	31.2	200
1990	100.0	100.0	167	3 531	14 227	58 214	100	137.0	27.0	-1 914
1991	98.9	96.9	133	1 043	12 803	50 871	88	136.9	26.7	-3 564
1992	99.5	96.0	133	361	11 590	49 885	88	120.3	36.5	-1 382
1993	103.0	99.2	148	3 039	10 989	50 696	89	141.2	44.1	-1 334
1994	106.8	101.9	158	5 406	11 239	54 226	102	158.9	42.9	955
1994 1	105.7	101.5	163	1 087	2 695	13 635	99	37.9	12.3	313
2	106.3	101.6	162	1 271	2 774	13 294	96	39.8	10.9	94
3	107.1	101.6	154	1 460	2 823	13 531	111	40.8	10.0	190
4	107.3	101.9	153	1 588	2 947	13 766	107	40.4	9.7	358
1995 1	107.2	101.4	160	..	..	..	95	36.8	9.1	..

1. Received by mechanical, instrument and electrical engineering, excluding transport equipment.

Source: Central Statistical Office, *Economic Trends and Monthly Digest of Statistics*.

Table E. **Production and manpower**
Seasonally adjusted

	GDP at factor cost	GDP per person employed ¹	Industrial production	Manufacturing production	Unemployed ²	Unfilled vacancies (adults)	Employment		Hour of overtime worked in manufacturing industries
							Total	Manufacturing industries	
	1990 = 100				Thousand		1990 = 100		Million per week
1985	85.2	92.7	88.0	84.5	3 113	162	91.3	103.6	11.98
1986	88.6	95.8	90.1	85.7	3 180	189	91.6	101.3	11.72
1987	92.7	98.8	93.7	89.6	2 822	235	93.8	100.5	12.63
1988	97.3	100.4	98.2	95.9	2 294	249	96.9	101.8	13.42
1989	99.4	100.2	100.3	100.2	1 784	220	99.3	102.1	13.44
1990	100.0	100.0	100.0	100.0	1 662	174	100.0	100.0	12.44
1991	97.9	100.7	96.1	94.6	2 287	118	97.3	93.5	9.63
1992	97.4	102.6	95.9	94.0	2 765	117	95.0	88.8	9.46
1993	99.5	105.8	98.1	95.2	2 901	128	94.0	86.8	9.09
1994	103.4	109.6	103.3	99.1	2 637	158	94.4	86.1	9.39
1994 1	101.7	108.0	100.8	97.2	2 750	141	94.1	86.3	9.37
2	103.1	109.6	103.0	98.8	2 665	149	94.1	86.1	9.15
3	104.0	110.2	104.3	99.9	2 585	162	94.4	86.0	9.26
4	104.8	110.5	104.9	100.6	2 468	179	94.8	86.1	9.77
1995 1	105.8	..	105.0	100.5	2 368	174	..	..	9.62

1. Based on output-based GDP.

2. Claimants aged 18 and over.

Source: Central Statistical Office, *Economic Trends*, and Department of Employment, *Employment Gazette*.

Table F. **Wages, prices and external position**

Seasonally adjusted

	Average earnings ¹	Producer prices manufacturing, home market*	Retail prices*	Exports	Imports	Exports (fob)	Imports (fob)	Visible trade	Current balance
				Unit values*					
	1990 = 100	1990 = 100				£ million			
1985	66.1	79.4	75.0	98.1	96.3	77 991	81 336	-3 345	2 238
1986	71.3	83.8	77.6	88.4	91.8	72 627	82 186	-9 559	-871
1987	76.8	86.7	80.8	91.4	94.5	79 153	90 735	-11 582	-4 983
1988	83.5	89.8	84.7	92.5	93.8	80 346	101 826	-21 480	-16 617
1989	91.1	94.1	91.3	96.6	98.1	92 154	116 837	-24 683	-22 512
1990	100.0	100.0	100.0	100.0	100.0	101 718	120 527	-18 809	-19 035
1991	108.0	105.4	105.9	101.5	101.6	103 413	113 697	-10 284	-8 176
1992	114.6	108.7	109.8	106.4	104.1	107 343	120 447	-13 104	-9 831
1993	118.5	113.0	111.5	114.9	111.3	121 300	134 694	-13 394	-11 800
1994	123.3	115.8	114.3	118.4	114.9	135 200	145 727	-10 527	-168
1994 1	122.9	114.9	112.6	117.1	111.2	31 758	35 099	-3 341	-1 435
2	122.6	115.6	114.6	118.5	114.9	33 209	35 621	-2 412	-728
3	123.2	116.0	114.7	119.0	116.4	34 701	36 530	-1 829	1 367
4	124.2	116.8	115.4	118.8	116.9	35 532	38 477	-2 945	628
1995 1	127.5	111.1	116.4	..	..	..	..	..	..

* Not seasonally adjusted.

1. From 1988 onwards, data are 1988 = 100; the pre-1988 data have been estimated from previous 1985 = 100 figures.

Source: Central Statistical Office, *Economic Trends*, and Department of Employment, *Employment Gazette*.

Table G. Net capital transactions

Not seasonally adjusted, £ million

	Current balance	UK investment overseas			Lending overseas by		Other external government transactions	Total investment and other capital transactions	Drawings on (+) or additions to (-) reserves	Balancing item
		Total	Direct	Portfolio	UK banks	UK resident other than banks and general government				
1985	2 238	-10 924	-3 943	-6 981	7 018	2 637	-706	-1 975	-1 758	1 495
1986	-871	-16 273	-5 812	-10 461	13 154	3 168	-332	-283	-2 891	4 045
1987	-4 983	17 859	-9 698	27 557	1 260	-1 494	1 097	18 722	-12 012	-1 727
1988	-16 617	-3 533	-8 857	5 324	14 637	2 555	77	13 736	-2 761	5 642
1989	-22 512	-23 381	-2 936	-20 445	16 426	19 297	1 854	14 196	5 440	2 876
1990	-19 035	3 255	8 024	-4 769	7 285	8 073	-344	18 269	-76	842
1991	-8 176	-11 726	-139	-11 587	9 580	16 691	-3 247	11 298	-2 679	-443
1992	-9 831	-5 458	-1 707	-3 751	-5 048	14 329	-1 861	1 962	1 407	6 462
1993	-11 800	-50 950	-7 433	-43 517	28 329	34 917	-3 681	8 615	-698	3 887
1994	-168	34 916	-12 186	47 102	-2 002	-37 013	-603	-4 702	-1 044	5 913
1994 1	-902	35 050	-691	35 741	-11 313	-25 241	-456	-1 960	-281	3 142
2	-2 158	11 698	-2 127	13 825	-8 876	234	750	3 806	-286	-1 362
3	471	1 428	-1 780	3 208	4 770	-9 898	-343	-4 043	-201	3 773
4	2 421	-13 260	-7 588	-5 672	13 417	-2 108	-554	-2 505	-276	360

Source: Central Statistical Office, *Financial Statistics*.

Table H. Foreign assets and liabilities

End of period

	Effective exchange rate	Official reserves		External assets of the UK			UK liabilities to overseas residents			Outstanding official borrowing from abroad ¹
		Total	of which: Convertible currencies	Total	of which: UK investment overseas		Total	of which: Overseas investment in UK		
					Direct	Portfolio		Direct	Portfolio	
1990 = 100		\$ million		£ billion						\$ million
1985	100.0	15 543	8 486	593.6	69.4	99.4	522.7	44.3	33.0	14 637
1986	91.5	21 923	13 781	720.9	80.7	140.1	622.4	51.7	49.0	19 325
1987	90.1	44 326	35 726	695.2	85.3	112.9	634.3	62.6	67.9	19 069
1988	95.5	51 685	42 184	775.4	104.3	145.6	711.7	76.8	86.7	15 751
1989	92.6	38 645	30 453	958.7	124.0	215.2	903.7	99.8	117.6	14 035
1990	91.3	38 464	30 553	911.1	121.9	186.9	915.7	113.2	117.6	14 542
1991	91.7	44 126	36 122	950.4	126.9	240.0	952.1	119.3	146.0	17 191
1992	88.4	41 654	34 338	1 176.4	149.7	302.8	1 165.7	121.8	190.8	32 982
1993	80.2	42 926	36 210	1 387.9	170.9	437.2	1 367.0	132.9	257.8	29 291
1994	80.2	43 898	36 223	1 412.3	186.1	418.5	1 376.0	140.5	264.4	28 334
1994 1	81.3	42 915	35 327	1 396.4	174.2	422.1	1 356.8	135.0	259.4	26 497
2	80.0	43 374	35 887	1 371.5	177.3	408.9	1 330.6	138.1	252.1	27 104
3	79.1	43 476	35 865	1 385.1	181.4	407.5	1 345.1	140.6	258.7	28 080
4	80.2	43 898	36 223	1 412.3	186.1	418.5	1 376.0	140.5	264.4	28 334

1. The valuation of these public sector liabilities differs from that used for the official reserves. Total official debt outstanding at end-January 1995 valued on the same basis as the official reserves was \$25 555 million.

Source: Bank of England, *Quarterly Bulletin*, and Central Statistical Office, *Financial Statistics*.

Table I. **General government appropriation account**

£ billion

	Taxes on income	Taxes on expenditure	Social security contributions	Property and entrepreneurial income ¹	Total current receipts	Final consumption	Subsidies	Debt interest	Current transfers ²	Total current expenditure	Current surplus	Gross capital formation	Net capital transfers ³	Net lending	Net lending per cent of GDP
1985	51.6	56.7	24.2	14.6	147.1	75.3	7.2	17.6	48.8	148.9	-1.8	7.3	-0.9	-10.1	-2.8
1986	52.0	62.9	26.2	12.8	153.8	80.9	6.3	17.1	51.7	156.0	-2.2	7.3	0.2	-9.3	-2.4
1987	55.7	69.0	28.6	13.2	166.5	87.0	6.3	17.9	54.1	165.3	1.2	7.1	0.1	-5.8	-1.4
1988	61.7	76.0	32.1	13.6	183.5	93.6	6.0	18.2	55.4	173.3	10.2	6.2	0.6	4.6	1.0
1989	70.1	80.0	32.9	15.5	198.4	101.8	5.8	18.9	58.3	184.8	13.6	9.4	0.5	4.7	0.9
1990	76.8	78.3	34.7	23.6	213.3	112.9	6.1	18.7	63.5	201.3	12.1	12.8	-5.7	-6.4	-1.2
1991	75.0	85.4	36.4	22.6	219.4	124.1	6.0	17.0	70.4	217.5	2.0	12.3	-4.4	-14.7	-2.6
1992	73.8	87.5	37.2	22.4	220.9	131.9	6.4	17.1	84.9	240.3	-19.4	12.4	-4.7	-36.6	-6.1
1993	73.1	91.7	38.8	22.5	226.1	138.7	7.5	18.5	93.8	258.5	-32.4	11.1	-5.9	-49.6	-7.9
1994	80.3	96.6	42.0	23.1	242.1	144.4	6.9	22.2	98.1	271.6	-29.5	12.1	-4.5	-46.1	-6.9
Seasonally adjusted															
1994 1	18.8	23.4	10.2	5.8	58.2	35.6	1.7	5.8	24.8	67.9	-9.7	3.8	-1.4	-14.9	-8.6
2	19.5	24.2	10.2	5.6	59.5	35.9	1.7	5.1	24.5	67.3	-7.7	2.6	-1.2	-11.5	-8.1
3	20.4	24.3	10.4	5.8	60.9	36.3	1.7	5.4	24.6	68.1	-7.2	2.9	-1.0	-11.1	-6.9
4	21.6	24.8	11.2	5.9	63.5	36.6	1.7	5.8	24.2	68.4	-4.9	2.8	-0.9	-8.6	-4.1

1. Includes community charge (from 2nd quarter of 1989) which is not treated as a tax on expenditure.

2. Social security, other grants to personal sector and net current grants paid abroad.

3. Taxes on capital and net grants and other transfers.

Source: Central Statistical Office, *Financial Statistics*.

Table J. Foreign trade by area
\$ million, monthly averages

	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
	Imports, cif											
OECD	6 853	7 204	7 652	8 870	10 906	13 406	13 985	15 817	14 627	15 296	14 206	15 715
<i>of which:</i>												
North America ¹	1 162	1 256	1 290	1 242	1 502	1 933	2 092	2 502	2 335	2 315	2 310	2 541
OECD Europe	5 135	5 406	5 780	6 890	8 502	10 331	10 745	12 089	11 113	11 685	10 642	11 841
<i>of which:</i> EU ²	4 474	4 667	4 980	6 056	7 502	9 201	9 587	10 713	9 845	10 448	9 433	10 643
Central and eastern European countries	29	30	32	42	50	57	58	64	54	54	41	40
Developing countries	1 445	1 516	1 460	1 551	1 786	2 210	2 327	2 672	2 680	2 898	3 059	3 271
<i>of which:</i> OPEC	331	286	277	202	207	250	265	389	366	406	417	351
Total ³	8 343	8 765	9 160	10 513	12 803	15 774	16 469	18 669	17 470	18 362	17 955	19 080
	Exports, fob											
OECD	5 741	6 038	6 665	6 941	8 596	9 544	10 083	12 425	12 497	12 706	12 019	13 700
<i>of which:</i>												
North America ¹	1 194	1 287	1 460	1 502	1 797	1 900	1 984	2 258	1 970	2 081	2 216	2 497
OECD Europe	4 291	4 474	4 904	5 101	6 377	7 137	7 502	9 468	9 956	10 058	9 229	10 525
<i>of which:</i> EU ²	3 972	4 150	4 581	4 707	5 879	6 622	6 983	8 825	9 326	9 467	8 606	9 836
Central and Eastern European countries	49	50	53	61	71	84	83	104	98	89	84	91
Developing countries	1 847	1 750	1 729	1 863	2 139	2 336	2 426	2 721	2 695	2 863	3 025	3 351
<i>of which:</i> OPEC	666	561	555	578	625	641	693	725	748	776	712	602
Total ³	7 652	7 852	8 462	8 918	10 874	12 078	12 715	15 376	15 405	15 801	15 767	17 211

1. Canada, Mexico and USA.

2. Fifteen members.

3. Including unspecified

Source: OECD, *Foreign Trade Statistics*.

Table K. Domestic finance

	Change in wide monetary base* M0	Change in broad money M4	General government borrowing requirement	Sterling lending to private sector by banks	Net increase in building society shares and deposits	Building society new commitments to mortgages	Government securities-calculated redemption yields ¹			Local authority deposits, 3-month rates	Comparison between local authority and Euro-dollar, 3-month rates ²
							Short-dated	Medium-dated	Long-dated		
							£ million					% per annum			% per annum at end of period
1985	182	25 873	8 398	34 024	7 462	27 763	11.13	11.06	10.62	11.94	0.08
1986	260	34 714	3 288	47 085	6 592	37 850	10.01	10.06	9.87	11.31	0.25
1987	209	42 481	-603	53 109	7 328	36 781	9.36	9.57	9.48	8.88	0.33
1988	401	52 509	-9 155	83 077	13 052	51 314	9.66	9.67	9.36	13.19	0.38
1989	336	64 393	-7 126	88 916	7 895	47 902	10.71	10.18	9.58	15.03	0.42
1990	158	51 575	-1 517	71 269	6 582	43 039	12.08	11.80	11.08	14.00	0.51
1991	139	28 291	8 313	35 862	6 006	41 864	10.18	10.11	9.92	10.93	0.08
1992	132	18 948	29 455	24 954	304	32 871	8.94	9.06	9.12	7.00	0.16
1993	291	25 053	44 425	21 040	2 190	33 780	6.65	7.47	7.87	5.31	0.12
1994	458	24 817	39 420	29 553	1 787	38 819	7.83	8.17	8.05	6.50	-0.06
1994 1	83	8 338	13 754	4 274	-1 279	9 040	6.23	6.79	6.90	5.25	-0.04
2	143	4 497	12 061	5 798	717	10 679	7.96	8.35	8.20	5.13	-0.03
3	135	4 861	9 001	8 229	782	9 951	8.53	8.79	8.55	5.88	-0.06
4	97	7 121	4 604	11 252	1 567	9 149	8.61	8.74	8.53	6.50	-0.06
1995 1	107	13 782	12 270	17 007	1 766	9 012	8.64	8.73	8.54	6.56	0.04

* Seasonally adjusted.

1. Figures are the average of working days.

2. Difference between the local authority rate net of the cost of forward cover and the Euro-dollar rate, last working day figures.

Source: Bank of England, *Quarterly Bulletin*, and Central Statistical Office, *Financial Statistics*.

Table L. **Labour market indicators**
1979-1994

	Peak		Trough		1990	1991	1992	1993	1994	
Per cent of total labour force										
A. Evolution										
Standardised unemployment rate	1983	12.4	1979	5.0	6.8	8.8	10.1	10.5	9.6	
Unemployment rates										
Total	1986	11.6	1979	4.6	5.8	8.0	9.7	10.3	9.3	
Male ¹	1993	14.0	1979	5.5	7.1	10.7	13.2	14.0	12.6	
Female ¹	1986	8.9	1990	3.3	3.3	4.5	5.3	5.5	5.0	
Youth (under 25 years) ¹	1983	23.4	1990	8.1	8.1	12.8	15.4	17.3	15.5	
Share of long-term unemployment ²	1985	48.2	1991	26.9	32.0	26.9	34.9	42.1	44.8	
Vacancy rate	1988	8.7	1981	3.4	6.0	4.1	4.1	4.5	5.6	
					1984	1990	1991	1992	1993	1994
Per cent										
B. Structural or institutional characteristics										
Participation rates ^{3, 4}										
Global				77.6	80.3	79.8	78.9	78.5	78.4	
Male				88.0	88.4	87.8	86.5	85.6	85.3	
Female				66.1	71.5	71.2	70.6	70.8	70.8	
Part-time employment rates ^{3, 5}										
Global				19.3	20.3	20.8	22.1	22.8	23.4	
Male				3.1	4.1	4.3	5.1	5.6	6.2	
Female				43.0	41.9	42.5	43.7	44.2	44.9	
Work-related government training programmes (thousand) ⁶				194	423	363	340	325	303	
Self-employment rate ⁵				10.9	12.9	12.8	12.5	12.5	12.9	

1. Per cent of respective labour force.

2. People looking for a job since one year or more as a percentage of total unemployment.

3. Data are the Spring non-seasonally adjusted data of the Labour Force Survey and are for Great Britain.

4. Defined as the total labour force divided by the population of working age (16-59/64).

5. Per cent of total employment.

6. Estimates of numbers consist of those participants in programmes and schemes (YTS, JTS, ET) who in the course of their participation in the programmes receive training in the context of a workplace but are not employees, self-employed or HM Forces.

Source: Department of Employment, *Employment Gazette*; OECD, *Labour Force Statistics*.

Table M. Production structure and performance indicators

	GDP share 1990 prices				Employment share (employees)			
	1982	1985	1990	1993	1982	1985	1990	1993
Per cent								
A. Production structure								
Agriculture, forestry and fishing	2.1	2.1	1.9	1.9	1.7	1.6	1.3	1.3
Production industries	29.2	29.0	28.1	27.6	30.6	27.8	24.2	21.9
Mining	3.4	3.3	2.2	2.5	1.7	1.4	0.8	0.6
Energy and water supply	2.3	2.2	2.2	2.4	1.6	1.4	1.2	1.1
Manufacturing (revised definition)	23.5	23.5	23.7	22.7	27.3	25.0	22.2	20.2
Construction	6.0	6.2	7.2	6.3	5.0	4.8	4.7	3.9
Services industries	62.6	62.6	62.6	62.6	62.6	62.6	62.6	62.6
Distribution, hotels and catering; repairs	13.0	13.6	14.2	14.2	19.3	20.0	21.2	21.4
Transport and communication	7.7	7.9	8.4	8.7	6.4	6.2	6.0	5.8
Banking, finance, insurance, business services and leasing	17.2	17.8	18.6	18.7	8.9	10.2	12.4	12.9
Other services ¹	24.7	23.3	21.4	21.0	28.0	26.2	23.0	22.5
	1987	1988	1989	1990	1991	1992	1993	1994
B. Productivity growth²								
Whole economy	2.7	1.5	-0.3	-0.2	0.7	1.9	3.1	3.6
Total production industries	5.2	3.9	2.2	1.7	2.6	5.3	5.5	6.8
of which: Manufacturing (revised definition)	5.4	5.6	4.1	1.9	1.2	4.5	3.8	4.8

1. Including sewage and refuse disposal.

2. Output per person employed, based on the output measure of GDP. The employed labour force comprises employees in employment, the self-employed and HM Forces.

Source: Central Statistical Office, *Blue Book*; Department of Employment, *Employment Gazette*.

Table N. Public sector

	1980	1985	1990	1993	1994
	Per cent of GDP				
A. Structure of expenditure and taxation					
Expenditure, total	43.0	44.0	39.9	43.7	43.1
Current consumption	21.6	21.1	20.5	22.0	21.6
Transfers to households	11.3	13.7	11.5	14.9	14.7
Subsidies	2.5	2.0	1.1	1.2	1.0
Fixed investment	2.5	2.0	2.3	1.8	1.7
Other	5.1	5.2	4.4	3.8	4.1
Tax receipts, total	39.7	43.0	38.8	40.2	40.4
Income tax	13.4	14.4	13.9	11.6	12.0
of which:					
Personal income tax	11.1	10.6	11.2	10.1	10.2
Corporate profits tax	2.3	3.9	2.8	1.5	1.8
Social security contributions	10.6	12.7	10.7	14.1	13.9
Taxes on goods and services	15.7	15.9	14.2	14.5	14.5
<i>Memorandum item:</i>					
Net lending	-3.4	-2.8	-1.2	-7.9	-6.7
	1980	1985	1990	1992	1993
	Per cent				
B. Taxation					
Personal income tax					
Lowest marginal tax rate	30	30	25	20	20
Highest marginal tax rate	60	60	40	40	40
Number of brackets ¹	6	6	2	3	3
Marginal income tax rate (for single average production worker)	30	30	25	25	25
Social security contributions					
Marginal contribution rate (for single average production worker)	20.5	19.5	19.4	19.4	20.2
of which:					
Employees' contribution rate	6.75	9	9	9	10
Employers' contribution rate	13.75	10.5	10.4	10.4	10.2
Corporate income tax rate	52	40	34	33	33
VAT standard rate ²	15.0	15.0	15.0	17.5	17.5

1. There were two tax brackets from April 1988 to March 1992.

2. VAT standard rate was increased to 17.5 per cent from 1 April 1991.

Source: Central Statistical Office; OECD, *The Tax/Benefit Position of Production Workers*; International Bureau of Fiscal Documentation, *European taxation* (various issues).

Table O. **Financial markets**

	1980	1985	1990	1992	1993
A. Size of financial sector					
Sector employment/total employment (all persons – per cent)	1.7	1.9	2.2	2.1	2.1
Financial assets/GDP (Banks only)	1.0	1.7	1.9	1.9	1.9
Securities market capitalisation/GDP	1.2	3.1	3.8	3.4	4.1
B. Structure					
Financial institutions' share of financial assets	..	55.9	57.4	57.1	57.1
Household sector portfolio (share of total financial assets):					
Short-term assets	..	..	36.5	33.8	29.6
Long-term assets	..	..	63.5	66.2	70.4
Non-financial corporate sector portfolio: (share of total financial liabilities)					
Debt	53.4	51.0	51.6	..	..
Short-term	42.7	42.5	31.7	..	..
Long-term	10.7	8.5	19.9	..	..
Equity	46.6	49.0	48.4	..	..
Share capital	18.2	8.0	7.3	..	..
Retained earnings and other	28.4	41.0	41.1	..	..
C. Internationalisation of markets					
Foreign banking presence in domestic banking sector: ¹					
Assets	68.5	72.6	59.7	63.3	..
Liabilities	63.8	64.8	50.0	52.3	..
Share of cross-border transactions: ²					
Net purchases of foreign securities by domestic residents	29.9	164.1	-187.6	-147.0	164.3
Net purchases of domestic securities by foreign residents	12.9	94.8	-135.6	-126.9	76.8
D. Other indicators (all commercial banks - per cent)					
Interest rate margins ³	3.77 ⁴	3.1	2.9	2.6	2.4
Operating expenses to total assets	3.44 ⁴	3.1	3.2	3.0	2.8

1. As a percentage of commercial banks' balance sheets.

2. Ratio of cross-border portfolio transactions to net issues of securities on domestic securities market.

3. Interest income minus interest expenses divided by total assets.

4. Break in series in after 1984.

Source: Central Statistical Office, *Financial Statistics, Blue Book*; OECD, *Bank Profitability*.

BASIC STATISTICS

***BASIC STATISTICS:
INTERNATIONAL COMPARISONS***

BASIC STATISTICS: INTERNATIONAL COMPARISONS

Units	Reference period ¹	Australia	Austria	Belgium	Canada	Denmark	Finland	France	Germany	Greece	Iceland	Ireland	Italy	Japan	Luxembourg	Mexico	Netherlands	New Zealand	Norway	Portugal	Spain	Sweden	Switzerland	Turkey	United Kingdom	United States	
Population																											
Total	Thousands	1992	17 489	7 844	10 045	28 436	5 171	5 042	57 374	80 569	10 300	260	3 547	56 859	124 320	390	89 540	15 184	3 443	4 287	9 858	39 085	8 668	6 875	58 400	57 998	255 610
Inhabitants per sq. km	Number	1992	2	94	329	3	120	15	105	226	78	3	50	189	329	150	45	372	13	107	77	19	166	75	237	27	
Net average annual increase over previous 10 years	%	1992	1.4	0.4	0.2	1.5	0.1	0.4	0.5	2.7	0.5	1.1	0.2	0.5	0.6	2.1	0.6	0.8	0.4	0	0.3	0.4	0.6	2.2	0.3	1	
Employment																											
Civilian employment (CE) ²	Thousands	1992	7 637	3 546	3 724	12 240	2 613	2 163	22 032	28 708	3 634 (91)	140 (91)	1 113 (91)	21 271	64 360	162 (91)	23 403 (90)	6 576	1 467	1 970	4 498	12 359	4 195	3 481	18 600	25 175	117 598
Of which: Agriculture	% of CE		5.3	7.1	2.6	4.4	5.2	8.6	5.2	3.1	22.2 (91)	10.7 (91)	13.8 (91)	8.2	6.4	3.7 (91)	4	10.8	5.6	11.6	10.1	3.3	5.6	43.9	2.2	2.9	
Industry	% of CE		23.8	35.6	27.7	22.7	27.4	27.9	28.9	38.3	27.5 (91)	26.4 (91)	28.9 (91)	32.2	34.6	31.5 (91)	27.8 (90)	24.6	22.6	23.5	33.2	32.4	26.5	33.9	22.1	26.5	24.6
Services	% of CE		71	57.4	69.7	73	68.7	63.5	65.9	58.5	50.2 (91)	62.9 (91)	57.2 (91)	59.6	59	64.8 (91)	49.6 (90)	71.4	66.6	71	55.3	57.5	70.2	60.6	34	71.3	72.5
Gross domestic product (GDP)																											
At current prices and current exchange rates	Bill. US\$	1992	296.6	186.2	220.9	563.7	141.6	106.4	1 322.1	1 801.3	77.9	6.9	51	1 220.6	3 662.5	10.6	329.3	320.2	41.1	113.1	84.2	576.3	247.2	240.9	159.1	1 042.8	5 937.3
Per capita	US\$		16 959	23 616	21 991	19 823	27 383	21 100	23 043	27 770	7 562	26 595	14 385	21 468	29 460	27 073	3 678	21 089	11 938	26 386	8 541	14 745	28 522	35 041	2 724	17 981	23 228
At current prices using current PPPs ³	Bill. US\$	1992	294.5	142	181.5	536.8	91.2	73.2	1 063.7	1 328.2	85.1	4.4	45.3	1 005.9	2 437.2	8.5	493.1	257.2	49.2	75.7	93.9	500.2	143.3	152.8	297.3	941.1	5 953.3
Per capita	US\$		16 800	18 017	18 071	19 585	17 628	14 510	18 540	20 482	8 267	17 062	12 763	17 373	19 604	21 833	5 507	16 942	14 294	17 664	9 743	12 797	16 526	22 221	5 019	16 227	23 291
Average annual volume growth over previous 5 years	%	1992	2	3.4	3.1	1.1	1.1	-0.1	2.4	4	2.2	-0.1	5.6	2.2	4.2	3.1	3	0.4	1.3	3.3	3.3	0.6	1.7	3.7	0.9	1.9	
Gross fixed capital formation (GFCF)																											
Of which: Machinery and equipment	% of GDP	1992	19.7	25	19.1	18.8	15.1	18.5	20	20.9	18	17.5	15.9	19.1	30.8	27.7	20.8	20.3	16.4	19.2	26.2	21.8	17	23.7	23	15.6	15.6
Residential construction	% of GDP		9.3	9.9	8.6	6.2	6.8	8.8	9.2	7.9	5.3	6.7	8.9	12.4	..	10.6	9.4	8.2	..	..	..	6.8	6.2	8	8.5	7.2	7.2
Average annual volume growth over previous 5 years	%	1992	5.1	5.7	4.6	6.4	3	4.6	5.1	6.1	3.8	4.8	4.3	5.3	5.2	..	4.5	5	4.1	..	..	4.3	5.9	15.7 ¹⁰	7.6	3	3.7
Gross saving ratio ⁴	% of GDP	1992	-1	5.1	7.1	1.4	-4.2	-4.3	3.3	5	4.9	-3	2.9	2.7	6.5	6.5	8.9	2.5	-1.3	-5.4	6.8	6.2	-0.6	1.5	4.6	0.6	0.7
General government																											
Current expenditure on goods and services	% of GDP	1992	15.6	25.1	21.3	12.8	18	12.1	19.8	22.1	15.5	14.3	18.5	17.2	33.9	60.2	16.1	23.5	19.2	21	25.3	19.1	14.1	29.7	23.1	12.8	14.5
Current disbursements ⁵	% of GDP	1992	18.5	18.4	14.7	21.9	25.5	24.9	18.8	17.9	19.7	20.2	16.1	17.6	9.3	17.1	10.1 ⁹	14.5	16.3	22.4	18.3	17	27.8	14.3	12.9	22.3	17.7
Current receipts	% of GDP	1992	36.9	46.2	54.6	49.2	58.2	56.1	48.4	44.1	47.1	..	..	51.5	25.9	..	..	55.3	..	..	..	..	64.6	35.1	..	42.1	36.7
Net official development assistance	% of GNP	1992	33.1	48.3	49.7	43.7	57.3	53.2	46.1	45	39.9	34.8	..	43.6	34	..	..	54.1	..	..	..	..	59.6	34.7	..	38	31.6
Indicators of living standards																											
Private consumption per capita using current PPPs ³	US\$	1992	10 527	9 951	11 420	11 863	9 120	8 285	11 144	11 186	5 929	10 557	7 443	10 936	11 191	12 285	3 978	10 213	8 769	9 189	6 124	8 083	8 907	13 043	3 206	10 397	15 637
Passenger cars, per 1 000 inhabitants	Number	1990	430	382	387	469	311	386	413	480	169	464	228	478	282	470	85	356	440	378	260	307	418	441	29	361	568
Telephones, per 1 000 inhabitants	Number	1990	448	589	546	570	972	530	482	671	458	496	279	555	421	413	118	462	430	502	263	323	681	905	151	434	509
Television sets, per 1 000 inhabitants	Number	1989	484	475	447	626	528	488	400	506	195	319	271	423	610	252	127	485	372	423	176	389	471	406	174	434	814
Doctors, per 1 000 inhabitants	Number	1991	2	2.1	3.6	2.2	2.8	2.5	2.7	3.2	3.4	2.8	1.5	1.3	1.6	2.1	1.1	2.5	1.9	3.1	2.8	3.9	2.9	3	0.9	1.4	2.3
Infant mortality per 1 000 live births	Number	1991	7.1	7.4	8.4	6.8	7.5	5.8	7.3	7.1	9	5.5	8.2	8.3	4.6	9.2	43	6.5	8.3	7	10.8	7.8	6.1	6.2	56.5	7.4	8.9
Wages and prices (average annual increase over previous 5 years)																											
Wages (earnings or rates according to availability)	%	1992	5	5.4	4.1	4.4	4.7	7	3.9	5.1	17.7	..	5.1	6.9	4	..	5.3	2.7	3.9	5	..	7.7	7.3	..	8.3	2.9	
Consumer prices	%	1992	5.2	3	2.7	4.2	3.3	5	3.1	2.8	16.6	14.3	3.2	5.9	2.2	3	35.8	2.1	4.3	4.2	11.2	6	6.8	4.1	66.6	6.3	4.3
Foreign trade																											
Exports of goods, fob ⁶	Mill. US\$	1992	42 844	44 361	123 264 ⁷	134 696	39 732	23 956	235 911	429 727	9 541	1 571	28 297	178 217	339 553	.. ⁸	46 196	140 234	9 831	35 140	17 990	64 509	55 980	65 478	14 853	190 103	448 033
As % of GDP	%		14.4	23.8	55.8	23.9	28.1	22.5	17.8	23.9	12.2	22.7	55.5	14.6	9.3	..	14	43.8	23.9	31.1	21.4	11.2	22.6	27.2	9.3	18.2	7.5
Average annual increase over previous 5 years	%		10.1	10.4	8.2	7.4	9.2	4.3	9.8	7.9	6.2	3	12.1	8.9	8.1	..	17.7	6.5	10.4	14.5	13.7	4.8	7.5	7.5	7.8	12	
Imports of goods, cif ⁶	Mill. US\$	1992	40 751	54 038	125 133 ⁷	122 445	33 707	21 166	230 050	408 180	23 012	1 710	22 467	188 524	233 100	..	62 129	134 578	9 159	26 057	29 588	99 659	49 916	65 587	23 267	220 994	531 070
As % of GDP	%		13.7	29	56.6	21.7	23.8	19.9	17.4	22.7	29.5	24.7	44	15.4	6.4	..	18.9	42	22.3	23	35.1	17.3	20.2	27.2	14.6	21.2	8.9
Average annual increase over previous 5 years	%		8.6	10.7	8.4	6.9	5.8	2.4	8.5	12.4	10.7	1.6	10.5	8.6	9.2	..	36.1	8.1	4.8	2.9	17.4	15.3	4.2	5.3	10	7.5	5.5
Total official reserves⁴																											
As ratio of average monthly imports of goods	Ratio	1992	8 152	9 006	10 037 ⁷	8 314	8 032	3 792	19 657	66 158	3 486	362	2 502	20 104	52 089	..	13 776	15 954	2 239	8 684	13 912	33 094	16 454	24 185	4 480	26 648	43 831
			2.4	2	1	0.8	2.9	2.1	1	1.9	1.8	2.5	1.3	2.7	..	2.7	1.4	2.9	4	5.6	4	4	4.4	2.3	1.4	1	

* At current prices and exchange rates.

1. Unless otherwise stated.

2. According to the definitions used in OECD Labour Force Statistics.

3. PPPs = Purchasing Power Parities.

4. Gross saving = Gross national disposable income minus private and government consumption.

5. Current disbursements = Current expenditure on goods and services plus current transfers and payments of property income.

6. Gold included in reserves is valued at 35 SDRs per ounce. End of year.

7. Including Luxembourg.

8. Included in figures for Belgium.

9. Refers to the public sector including public enterprises.

10. Including non-residential construction.

Sources: Population and Employment: OECD, Labour Force Statistics. GDP, GFCF, and General Government: OECD, National Accounts, Vol. 1. Indicators of living standards: Miscellaneous national publications. Wages and Prices: OECD, Main Economic Indicators. Foreign trade: OECD, Monthly Foreign Trade Statistics, series A. Total official reserves: IMF, International Financial Statistics.

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EMPLOYMENT OPPORTUNITIES

Economics Department, OECD

The Economics Department of the OECD offers challenging and rewarding opportunities to economists interested in applied policy analysis in an international environment. The Department's concerns extend across the entire field of economic policy analysis, both macroeconomic and microeconomic. Its main task is to provide, for discussion by committees of senior officials from Member countries, documents and papers dealing with current policy concerns. Within this programme of work, three major responsibilities are:

- to prepare regular surveys of the economies of individual Member countries;
- to issue full twice-yearly reviews of the economic situation and prospects of the OECD countries in the context of world economic trends;
- to analyse specific policy issues in a medium-term context for the OECD as a whole, and to a lesser extent for the non-OECD countries.

The documents prepared for these purposes, together with much of the Department's other economic work, appear in published form in the *OECD Economic Outlook*, *OECD Economic Surveys*, *OECD Economic Studies* and the Department's *Working Papers* series.

The Department maintains a world econometric model, INTERLINK, which plays an important role in the preparation of the policy analyses and twice-yearly projections. The availability of extensive cross-country data bases and good computer resources facilitates comparative empirical analysis, much of which is incorporated into the model.

The Department is made up of about 80 professional economists from a variety of backgrounds and Member countries. Most projects are carried out by small teams and last from four to eighteen months. Within the Department, ideas and points of view are widely discussed; there is a lively professional interchange, and all professional staff have the opportunity to contribute actively to the programme of work.

Skills the Economics Department is looking for:

- a) Solid competence in using the tools of both microeconomic and macroeconomic theory to answer policy questions. Experience indicates that this normally requires the equivalent of a Ph.D. in economics or substantial relevant professional experience to compensate for a lower degree.
- b) Solid knowledge of economic statistics and quantitative methods; this includes how to identify data, estimate structural relationships, apply basic techniques of time series analysis, and test hypotheses. It is essential to be able to interpret results sensibly in an economic policy context.
- c) A keen interest in and extensive knowledge of policy issues, economic developments and their political/social contexts.

- d) Interest and experience in analysing questions posed by policy-makers and presenting the results to them effectively and judiciously. Thus, work experience in government agencies or policy research institutions is an advantage.
- e) The ability to write clearly, effectively, and to the point. The OECD is a bilingual organisation with French and English as the official languages. Candidates must have excellent knowledge of one of these languages, and some knowledge of the other. Knowledge of other languages might also be an advantage for certain posts.
- f) For some posts, expertise in a particular area may be important, but a successful candidate is expected to be able to work on a broader range of topics relevant to the work of the Department. Thus, except in rare cases, the Department does not recruit narrow specialists.
- g) The Department works on a tight time schedule with strict deadlines. Moreover, much of the work in the Department is carried out in small groups. Thus, the ability to work with other economists from a variety of cultural and professional backgrounds, to supervise junior staff, and to produce work on time is important.

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The salary for recruits depends on educational and professional background. Positions carry a basic salary from FF 305 700 or FF 377 208 for Administrators (economists) and from FF 438 348 for Principal Administrators (senior economists). This may be supplemented by expatriation and/or family allowances, depending on nationality, residence and family situation. Initial appointments are for a fixed term of two to three years.

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