5 UK Economic Decline: 'Myth' or Reality?[1]

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The performance of the UK economy has been viewed with pessimism for the past century. Complaints of low growth, insufficient investment, inadequate technical training, poor industrial relations and inept management have been familiar parts of the debate for this whole period.

The perceived problems of the UK economy have been addressed in varying ways, both at micro- and macro-level, throughout this century. In the 1920s the Rationalisation Movement tried to create more efficient corporate structures for business. In the post-Second World War period Keynesian demand management and economic planning attempted to improve the allocation and exploitation of resources within the economy. Initiatives such as nationalisation, education reforms, trade-union legislation, prices and incomes policies, taxation and subsidies can be seen as efforts aimed at addressing some of the basic causes of the UK's apparent inability to match the economic performance of the other developed economies. In the past 15 years' privatisation, labour market de-regulation and other attempts to 'roll back the frontiers of the State' have formed part of a programme explicitly intended to stimulate the UK's 'spirit of enterprise' and reverse its persistent relative decline.

A century of persistent dissatisfaction with Britain's economic performance can be viewed as a remarkable historical phenomenon in its own right, particularly when we consider that the past hundred years has been a period in which the UK's real living standards have almost quadrupled. The question therefore arises whether, and to what extent, this dissatisfaction is justified. It is also interesting to examine whether, as is sometimes claimed, there has been some improvement in Britain's performance over the past decade. These two issues are addressed in the following discussion.

What is Economic Decline?

Absolute economic decline would be defined as either shrinking activity for the economy as a whole, as defined by total GDP, or as falling average real living standards for the population of an economy. Whilst there have been a number of periods of absolute decline in activity and living standards in the UK, such declines have always been brief, covering no more than a couple of years, and they represent mere deviations from what, in many ways, has been a remarkably stable record of continued economic expansion.

On average, the UK economy has expanded by 1.7 per cent per annum this century; if we exclude the two World Wars, the annual average growth in total output has been some 2 per cent per annum. Looking at the principal sub-periods of the past century, i.e. the pre-First World War years, the two inter-war decades, and then the years since 1945, UK growth was at its lowest in the earliest periods and at its strongest in the 1950s, but the inter-period variation was only between average growth rates of 1.5 per cent per annum and 2.7 per cent per annum.

As Table 1 shows, Britain's growth performance has been the most stable of the major economies - but also the lowest. It is this relative growth under-performance that has been the nub of the dissatisfaction with the UK's record. It is an undeniable fact that the UK has lost ground over the past century to the US, its European neighbours and Japan in terms of economic expansion.

In particular, the relative under-performance against European countries such as Germany, France and Italy was seen as an especially serious issue. At the political level the key question that came to a head under the Thatcher government in the 1980s was whether the UK's relative decline must be accepted or whether it could be resisted and reversed.

Table 1: GDP growth

	UK	US	France	Germany	Italy	Japan
1900-13	1.5	4.0	2.6	2.9	2.6	-
1920-29	1.7	3.8	5.9	4.1	2.6	-
1929-38	1.9	0.1	-1.9	2.7	1.1	6.2
1950-60	2.7	3.3	4.6	8.0	5.5	8.8
1960-73	2.3	4.2	5.6	4.4	5.3	10.4
1973-79	1.6	2.7	3.1	2.4	2.6	3.7
1980-90	2.1	2.3	2.3	2.0	2.4	4.2

However, it is not very useful to regard the fact that the UK grew more slowly than economies which industrialised later than the UK as indicative of economic decline. Any technological or organisational lead will eventually be eroded, as other countries learn from the pioneers; and this will be reflected in the newly industrialising economies exhibiting a more rapid growth rate than the more mature economies. It is unreasonable to expect that a country as small as the UK could remain the largest economy in the world, as it was in 1850; or that it could continue to account for 40 per cent of world manufactured exports, as it did in the second half of the nineteenth century.

The Key Role of Productivity

A more meaningful measure of relative economic decline, or advance, is comparative productivity - both its absolute level and its growth rate. It is output per head that both defines the living standards that an economy can achieve for its population, and the level of technology and economic organisation in an economy. Furthermore, whilst more rapid growth rates must be expected in newly industrialising economies, there are less clear reasons why their absolute levels of productivity should exceed those of countries which industrialised earlier.

Table 2 shows GDP per head in 1900 and at various dates since then. The data for the earlier years have to be treated with some caution; but the general picture given by the figures is quite reliable. The US already had higher productivity than the UK in 1900 and substantially outperformed the UK during the first half of the twentieth century, to enjoy by far the world's highest level of GDP per head by 1950. Germany, by contrast, did not outperform the UK in terms of output per head in the first half of the century; and this is probably broadly true when comparing the UK with the rest of Europe. Interestingly, much the strongest outperformance by the US was registered in the two periods of world war. However, the period since 1950 tells a very different story, as the main European economies such as Germany and France overtook the UK. Italy grew much faster and by 1990 almost matched the UK in absolute terms, whilst the lead enjoyed by the US was cut back.

A slightly different measure of productivity levels and performance has been calculated by the economic historian Feinstein, who compared GDP per hour worked in the US, Germany, France, Italy, Japan, the UK, Belgium, The Netherlands and Sweden from 1870 to 1984. On this measure, the UK starts the period as the most productive economy of the nine included in the analysis and was only surpassed by the US and Sweden by 1950. Subsequently, the UK loses ground to the European economies, and ends up in 1984 as the least productive economy in absolute terms with the exception of Japan. The US also loses relative ground after 1950, with productivity close to European levels by the early 1980s and its lead over the UK cut from 70 per cent in 1950 to 24 per cent in 1984.

Table 2: GDP per head 1980 and purchasing power parity

	1900	1920	1950	1970	1990
UK	1249	1267	1888	3003	5150
US	1463	2006	3383	5100	7255
Germany	940	1086	1355	3601	5335
France	n.a.	n.a.	1515	3354	5294
Italy	690	810	1067	2836	5008
Japan	n.a.	n.a.	533	2925	5722

Source: Liesner, *Economic Statistics 1900-1983*, and NatWest Bank

On this basis the UK has clearly experienced relative decline, from being the leading economy in the world 125 years ago to a position well below many other industrial countries. But the same data also tell us that performances converge, with neither the US nor the UK sustaining their lead, and levels of output per hour are far closer between the world's leading economies now than they were 50 or 100 years ago. Furthermore, there is some evidence of relative improvement in the UK during the 1980s, indicating that the Thatcher attempt to halt and eventually reverse decline may have had some measure of success. This points to two issues worthy of further investigation: The UK's under-performance relative to Europe in the post-war period. Performance during the 1980s.

UK Performance in the Post-War Period

We have already noted the Feinstein research, showing how UK output per hour growth under-performed the major European economies, resulting in the absolute level of productivity falling below virtually all of them. Table 3 shows the growth rate of productivity between 1950 and 1984 for the economies considered.

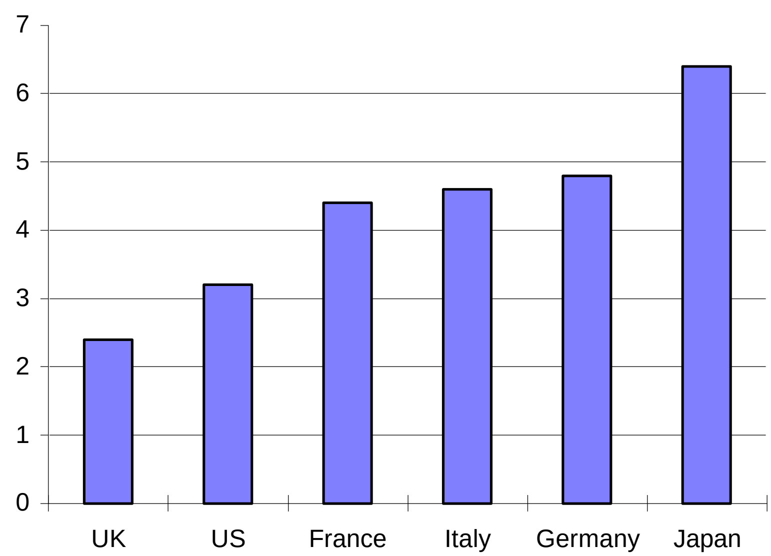
Table 3: GDP per hour worked: annual percentage growth 1950-84

Japan	6.2
Sweden	3.3
France	4.6
Germany	5.0
Italy	4.7
US	2.0
Belgium	4.1
Netherlands	3.6
UK	2.9

Source: Feinstein, OREP 1988.

This under-performance was also reflected in GDP growth. Chart 1 shows growth in GDP between 1950 and 1994 for the major economies.

Chart 1: The major economies: GDP growth 1950-1984



It was during this period, 1950-1984, that the perception of chronic under-performance by the UK economy set in, and also became a serious political issue despite the historically healthy rate of growth that the UK was actually delivering. The blame for the UK's failure to participate fully in the post-war boom has been laid at a number of doors, in particular its poor industrial relations, inadequate training and poor management. Other explanations, such as the UK's distinction in not being invaded and occupied in war and thus the continuance of 'sclerotic' entrenched interests and ways of doing things, have overlaid these criticisms. Much has also been made of the poor demand management in the UK, though the actual volatility of GDP growth in this period does little to support this contention. More recently, there has been criticism of the 'short-termism' of powerful investment institutions, that are said to be more interested in short-term financial return than in long-term industrial success. Whatever the explanation, the fact of relative under-performance in the 1950s and 1960s and to a certain extent the 1970s is undeniable.

UK Performance in the 1980s

The 1980s commenced with severe recessions in the UK and the rest of the industrialised world. The recession in the UK was particularly sharp, and hit manufacturing industry very hard. Employment fell by two million whilst unemployment rose to a level above three million. The ensuing recovery, starting in the early 1980s both in the UK and the rest of the OECD, was sustained for an exceptionally long period until 1990.

In the UK, growth accelerated to over 4 per cent in the late 1980s. In the midst of this boom, the UK's own alleged 'economic miracle' was being hailed, as the British economy grew more rapidly than the rest of Europe and matched the expansion of the US, as shown in Table 4.

Table 4: GDP growth 1980-1989

	% change p.a.
UK	2.4
US	2.5
EU	2.2
OECD	2.7

As Table 5 shows, Britain's relative productivity growth performance in the 1980s was even stronger in the business sector, most dramatically in the second half of the last decade.

Table 5: Productivity in the business sector 1980-1991

	% change p.a.
US	1.0
UK	2.2
OECD Europe	2.0
OECD	1.7

Source: OECD

Admittedly, in the light of the 1990 recession, those who talked in the late 1980s of an economic miracle have looked rather foolish. However, an examination of economic performance during and since the recession underlines the fact that the UK economy has undergone some significant changes for the better. Productivity rose through the recession, as employment fell by more than output; while company profitability remained high and has increased further during the recovery so far. The indications are that capital expenditure is set to expand strongly at a relatively early stage in the recovery.

Many of the developments in the UK economy during the 1980s impacted on, and probably altered for, the better, some of the factors accounting for Britain's under-performance since 1950. Industrial relations improved dramatically. The number of days lost to strikes per 1 000 employees in the UK in 1992 was 20, compared with an OECD average of 110. In fact in terms of strikes the UK has been consistently below the OECDs far higher average since 1986. The 1980s also saw a burst in entrepreneurship, with greater rates of new business creation than ever before. The structures that surrounded pay bargaining became more flexible, as the numbers of workers covered by collective bargaining fell and wages councils were dismantled. Comparative data on unit labour costs indicate that the UK is now competitive with Europe; its share of world trade has stabilised and has even risen marginally since the mid-1980s, after more than a century of decline.

Conclusions and Outlook

It is misleading to argue that the UK economy has been in decline for the whole of this century. Newly industrialising economies will always grow faster than mature ones, and this is evident in rapid Japanese growth between 1950 and the mid-1980s, as well as in rapid growth in economies such as South Korea, Taiwan, Hong Kong and Singapore over the past three decades. However, the UK performance in the 1950-1980 period is indicative of *relative* economic decline, as broadly similar economies in Europe developed output per head that substantially exceeded the level of the UK without any obvious advantages in resource endowment, geographic size or location.

In the past 15 years, however, the UK economy has performed relatively well compared with its industrial peers, particularly in Europe. Levels of productivity appear to be converging between all major industrialised economies, including the UK, as might be expected in a world of highly developed communications and mobile capital amongst the developed economies. Looking to the next decade, we expect the UK to slightly outperform the rest of Europe, as this process of convergence continues, but Europe as a whole will be under-performing the newly industrialising Far East and Latin America.

The UK's ability to secure a disproportionate amount, in relation to its size, of foreign direct investment and to sustain more liberal and flexible arrangements in its labour and other markets should enable the UK to perform as a relatively dynamic European economy over the next 10-20 years, and to cope better with problems of high unemployment and lack of industrial competitiveness.

Note

1. The author is grateful to his colleagues Mark Mitchell and Peter Gutmann, members of his Department, for their very valuable assistance.