Bruxelles, le 26 mars 1980

THE PERFORMANCE AND POTENTIAL OF BRITISH INDUSTRY
IN THE EUROPEAN COMMUNITY

Address to the Annual Convention of the Institute of Directors
by Etienne Davignon

Royal Albert Hall - London 25 March 1980
Ladies and Gentlemen,

The performance of British industry in relation to that of most of the rest of the European Community is one of the major issues at the centre of the Community's domestic policies today.

The British economy is an industrialised economy; it has been industrialised for longer than anywhere else in the world; your agricultural sector is indeed so small that the normal preoccupations with agricultural policy, taken for granted in other member states are virtually absent here.

But all is not well, and I hope you will bear with me if I use your invitation to address you about Britain's industrial performance and potential in the European Community as an opportunity to bring to this problem a European view. For we have learnt, if it were not already self-evident that the problems of one member state are indeed the problems of the Community as a whole.

I propose to address our subject from three points of view:

- structural change in the British economy in relation to experience elsewhere in the European Community;

  particular aspects of the British situation;

- the scope and potentialities of European policy.

Structural change

High growth rates before 1973 led to generally full employment, and growth to some extent has reflected a strengthening of the productive system, but partly concealed continuing disparities between member states.
There has been a sharp deterioration in the economic situation in all member states during the past few years; in particular the reappearance of unemployment. This is due in part to the persistence of structural factors which already existed before the present crisis began.

The effects are different among the member states; their industrial structure and performance are increasingly different, particularly their ability to adjust to change. It has reached a point where the individual member states' interest in particular Community policies are becoming increasingly divergent.

What are these disparities?

For example, when we look at the Community's international trade in manufactured products we learn that most member countries are more involved in products which are directly competing with those of the newly industrialising countries than are either Japan or the United States. In particular those products which embody very low skilled labour or a very low capital content. The former accounted for 56% of imports from the newly industrialising countries in 1976, the latter 34%. The corresponding figures for trade between developed countries are: 22% for products containing very low skilled labour and 6% for products with a very low capital content.

Whereas the USA and Japan have been reducing their involvement in these products - which is illustrated by their falling export market shares, the EEC as a whole has increased its share.

Among our member states, Italy an the United Kingdom are far more exposed in this respect than is the rest of the Community. In 1976 the UK and Italy accounted for 11 and 12% respectively of the market for activities with a very low skilled labour content. The share of the USA was 9%, and JAPAN's share was 10%, but these two countries are also much less specialised in this product range than either the UK or Italy.
The exposed countries risk losing their share of world markets and of the Community market to competition from the NIC's.

On the other hand the Community is by - and - large in a satisfactory position for products which need much skilled labour to make and which consequently embody high technology and provide well paid jobs. German and United Kingdom exports are still relatively specialised in these areas. The United States is in the strongest position here. Japan has not yet gained access to these markets - we are talking about aircraft, nuclear power, for example and the position of other member states, like Italy and France is improving but precarious, not least because we expect Japan to make a major effort to export in these areas in the near future.

When we look at exports of equipment and intermediate goods as well as industries depending on basic research and advanced technology, we find that JAPAN has doubled its export market share between 1963 and 1976 (from 7% to more than 15%) primarily at the expense of the USA and the United Kingdom. The United States, however, retains an important position with a 16.4% share of exports, whilst the UK share has fallen from 13% to 7%. Germany has retained some 20% of the world market in basic products since 1963.
Finally when we look at our position with respect to products which are fundamental to future technological development like research based products and services, computers, telecommunications, micro-electronics we find that these industries are concentrated in Japan, the United States and Germany, whereas their overall market share is in the region of 49% for manufactured products generally, it is as high as 60% in these activities, with Germany accounting for almost 20% in 1976. The other member states do not have a favourable position in these areas.

Japan has progressed spectacularly here; almost trading its share of export markets in these areas between 1963 and 1977. More specifically, JAPAN increased its export market share of advanced technology products from 8% in 1963 to nearly 23% in 1976. The United Kingdom, which started from a good position in these activities has been declining rapidly. In 1963 the UK accounted for 12% of exports in this area, by 1976 this was only 7%.

Thus, in addition to the well known gaps in standards of living, levels of wages, investment and productivity among the member states, there are very prejudicial disparities in the structure of industry, in its capacity to develop in the future, and its capacity to meet competition from the NIC's, Japan and the United States.

How did we get into this mess?

The structural problems of European industry are today an important constraint on the integration of Europe and on harmonious development of the economy and society during the next decade. This weakness is manifest in the inability of industry to create sufficient employment, and in the lack of international competitiveness.

As we have seen some parts of European industry embody highly sophisticated technology and produce goods very efficiently; indeed many firms are also able to sell at internationally competitive prices. Indeed some firms are able to meet any competition in the world. This is good, but no more than one would expect. But this is not the problem.
The problem is that those firms, or sectors, which are succeeding are not sufficiently numerous nor is their product sufficiently large, nor are they sufficiently widespread, to ensure either the necessary exports, or the employment in the context of the enhanced constraints of energy, materials and international competition we anticipate.

A second reason for disparities between member countries is their different economic history. The areas of nineteenth century industrialisation can now, with few exceptions be identified by their unfavourable industrial and social structure, location and infrastructure.

A further, major reason for the disparities which exist are the very different performances in terms of successful industrial investment. This can be explained partly in terms of a declining rate of profit and a low rate of investment but is also due to the unwillingness of some firms to invest in the face of high risks, to bad investment decisions taken by governments, and to the large proportion of research and development expenditure devoted to uneconomic activities.

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In this context I think it is necessary to pay particular attention to the position of the United Kingdom as the largest economy whose relative position is declining most rapidly.
The British Situation

If that problem can be solved, then other less difficult problems can be solved as well. If the problem cannot be solved then the European Community may look a very different place in ten years' time, than it does today; either the composition or its policies would have been changed.

In spite of the fact that in Germany, France and Italy several industrial sectors have recovered fairly well from the 1975 recession, in Britain nearly all industrial sectors have continued in recession. In addition to stagnating demand for consumer goods, equipment manufacturers have suffered from the continuing recession in investment. Most intermediate products (steel, minerals, construction goods) are also still in a severe recession. Chemicals is the only major sector which has performed relatively well. Among the smaller sectors, only precision goods and computers have shown some promising results.

Because of the very slow overall growth and the decline in industrial activities, the tertiary sector in Britain has come to represent a larger proportion of activity than anywhere else in the Community. This process of de-industrialisation in Britain is at best premature, and at worst debilitating. In the long-term there may well be some point in shifting industry away from traditional capital and energy-intensive activities. However, such a change must be associated with the development of other competitive activities which will provide employment and exports. This is not happening. In particular, it seems unwise to rely on the tertiary sector for export earnings, because apart from banking and insurance the new service activities which are being developed are increasingly related to the manufacturing process itself.

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By comparison beyond a general similarity with the United Kingdom, Italy shows quite different structural trends. The two countries share a low rate of investment, rapidly rising costs and periods of currency depreciation.

But as a result of remarkable effort to industrialise since the 1950s, the importance of manufacturing industry in Italy has steadily increased. Growth was rapid in sectors such as steel and machinery. And in the more traditional branches such as textiles and clothing, shoes and furniture Italy's much lower rate of productive investment compared to other European countries corresponds to a fairly high specialisation in more labour intensive sectors.

Britain's problems are Europe's problems for two very clear reasons; the disparities in industrial performance are a serious brake on the process of integrating the European market; and there is an uncomfortable parallel between Britain's performance compared with the rest of the Community and the risk of a future decline in Europe compared with the rest of the world, and particularly with Japan.

Consequently the Community cannot treat the British situation as a purely national situation and must participate in its solution.

Although Britain is not alone in having structural problems in its industry the situation is particularly preoccupying in the United Kingdom.

There are also some aspects of the current difficulties of British firms to which Europe does not have the solution, and they are certainly not of the Community's making.
In particular the high exchange rate, and very high interest rates which are hitting the exports, profitability and investment plans of many firms. The only solution we can offer to this situation would be for Britain to join the European Monetary System, at an appropriate exchange rate where British industry would be competitive, and to benefit from the stability, flexibility and resources which would be available through the EMS.

Productivity and Trade

Exports have fallen drastically from 13.7% in 1963 to 8.6% in 1977, while Germany's share remained constant, about 19% and France's share increased from 8.5% to 9.1%. Italy's share also increased from 5.8% to 7.1%. The shares of the other EEC countries were fairly stable.

UK share of world exports has also fallen markedly. In 1958 the UK accounted for 10% of world exports, in 1968 this was 7.2% and by 1978 5.7% (excluding intra-EEC trade). Other EEC countries either retained a fairly constant percentage share or increased their share; Germany for example increased its share of world exports from 9.3% in 1958 to 12% in 1978.

In all manufacturing sectors except agriculture and foodstuffs productivity is the lowest in the Community. The Italian figures are also low. In the period 1973-1977 the average annual growth rate of productivity in the UK was 0.4%, in industry it was -0.3%.

Comparible figures for Germany are 3.3% and 4.5%

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The slower growth rate of productivity in the UK with respect to Germany has been apparent for at least a century. In terms of manufacturing productivity Germany overtook the UK in the 1930s and decisively in the early 1950s. In 1976 W. Germany, France and the Benelux countries produced over 70% more per employee in industry than the UK and Italy some 15% more.
On present trends in a few years the UK will be overtaken by other future Community countries, particularly Spain.

Whilst Germany has consistently accounted for between a fifth and a quarter of manufactured exports throughout this century, the UK share has fallen from one third at the turn of the century to under one tenth now.

Further, the technological sophistication of the goods she does export has been seriously falling behind that of her main competitors. Unit values of engineering exports were broadly comparable between Germany, France and UK in the early 1960s but by 1975 German and French unit values were about 60% and 40% higher respectively. Consequently the UK has suffered a chronic and worsening balance of trade.

Britain's traditional export markets in Commonwealth countries outside Europe remained important right through the 1960s. Indeed it was only in 1973 that more than half UK exports went to Eastern and Western European countries.

By contrast, during the 1950s and 1960s the Community countries were experiencing a period of rapid growth and integration. Thus, I feel that a large part of the problem today is that Britain joined the Community too late, indeed at the worst possible moment, on the eve of an international recession.

UK has been slow to follow Germany's lead in developing new industries such as chemicals, electricity generation and advanced machinery and to move resources from declining to more advanced sectors.
In the 1980s the focus of economic activity will probably shift from W. Europe to the newly industrialising countries of Southern Europe, Latin America, and South-East Asia. Because of its position at the lower end of the product sophistication spectrum (i.e. increasingly producing products where price rather than non-price factors are important) UK is likely to be one of the countries most severely affected by competition from newly industrialising countries.

The role of Business and Government

I am conscious that in addressing the Institute of Directors, I am speaking to a large extent to those who have been responsible for the planning and strategic decision-making of British industry, for some time. Many of you have lived with the experience of British industry during the whole period when the foundations of the present crisis were laid; when the basic trends emerged which are now proving to be so prejudicial for the future.

What happened? Where did things go wrong?

First, it seems to me that with some notable exceptions there has been a lack of foresight and successful strategic planning. In the private sector this has been the responsibility of the firms themselves, particularly in Britain where I gather that many of you consider as a point of principle that it is the firm, not government which is responsible for the fundamental entrepreneurial decisions. I do not altogether disagree; but one then has to draw the corresponding conclusions.
For example, I am surprised, not to say disappointed, that as we enter a new round of international textile negotiations we face demands from the industry for an even longer period of more stringent protection; whereas the terms of the existing agreement, and a cursory review of international industrial development would have convinced most people - five years ago - that this would not be a tenable position today.

Thereagain, I wish that as we enter a period of rapid change arising from the information technologies, that the British firms in this sector had succeeded in sustaining the commanding position which they used to hold.

Secondly, several successive attempts to get the relationship between government and industry right have clearly failed in this country. I am not really thinking in terms of the party political debate here which you all know so well. I have more practical concerns:

Continuity: Industrial policy is about influencing the course of industrial development. Industrial structures can be changed more or less rapidly, they do not change overnight. Now, it is self-evident that policies which have failed must be changed, and the responsibility for change must be vested in those who are able and willing to carry it out. But industrial change involves thousands of firms and hundreds of thousands of working people. Changes in industrial policy should take account of the maximum speed at which change can be undertaken.

Communications: A distinguished and perspicacious Japanese economist (1) recently attributed the successful development of Japanese industry to:

- group dynamics between industrial managers and government officials producing better strategic decisions; and

(1) Professor Nishyama, Royal Institute for International Affairs, Brussels, 11 March 1980.
shopfloor worker participation giving rise to technological innovation and enhanced productivity.

Even allowing for a degree of - not unjustified - self-congratulation, the thesis bears thinking about; not least because no-one would suspect Japanese government and society of being un-responsive to business interests. Indeed the reverse is true.

What do we have to learn from successful examples of communications between government, managers, and employees? How do we learn it?

I do not pretend to have the answer but I do feel that there should be an "examen de conscience" in Government and Management as to why the British experience is so different from that of the rest of the industrial world.

Thirdly, there has been a particular problem of managing industrial development in the public sector, where through bad luck or bad judgment, serious errors have been made:

- in the investment plans of the steel industry;
- in the structure of the automobile industry;
- in national R and D priorities.

For my part I do not think that these problems can be resolved at this stage simply by returning to the private economy. All large industrial states have come to terms with the fact that the public authorities are irrevocably involved with the industrial economy.

True, the manifestations of this relationship vary from country to country. And I wish to draw your attention to one important point. The kind of relationship between government and industry which has emerged in the medium sized industrial economies is inappropriate to the scale of the modern economy.
Within the Common Market, public intervention originally conceived to counter private national monopolies loses its raison d'être in a larger, more competitive market. On the other hand the kinds of public intervention which have proved most effective in the United States - Government purchasing and financing of R and D - are inaccessible in Europe as long as heterogeneous industrial policies are dispersed among the member states.

Community policies

In this context the Community has several roles to play. In the first place, the Community should have a stabilising and moderating role on the relationships between government and industry; particularly as the larger market provides a theatre for positive and successful cooperation between public authorities and industry - as several member states have shown.

Secondly, we have to provide the countervailing arguments against the protectionist pressures which naturally arise in those sectors which are under greatest pressure. The Community still has more to lose than to gain from generalised protection, and we have to find alternative solutions to industrial adjustment. I know that at certain times in the past, other countries have successfully built up internationally competitive industries, behind protective barriers, but would such an approach be effective in the UK today, when the principal problem seems to be the inadequate response of British firms to evident market trends.

Would general protection change attitudes in this crucial respect?

Thirdly, the Community has an essential role in achieving agreement when trade policies are necessary. There are several examples where the Community does have to manage its international trade. Needless to say the outcome is not to everyone's satisfaction but I have no doubt that both within the Community and internationally the exceptions to free trade will be more acceptable and less damaging if they are based on an agreed Community position. The Community has shown it can reach reasonable agreed solutions in this area. Unilateral action is not acceptable.
Finally, the Community must develop industrial policies which are appropriate to the new situation since the energy crisis and the recession.

The Common Market policies which succeeded during the period of high growth in integrating the market in most of the original member states are clearly insufficient in the present context. I need not tell you that the Community has to date singularly failed to reach decisions in this area.

I think the fundamental reason for this is that the successful countries cannot accept policies which would inhibit the performance of their best firms, nor accept policies which in effect give a blessing to national policies which have been shown to be ineffective.

On the other hand, Community policies must be able to extend the methods and resources of successful policies to the Community as a whole, whether the example comes from one of the member states or from an international competitor.

For example, the information industries - communications, computers, micro processors - have developed in Japan and the United States well beyond our own capacities.

European industry cannot afford to let such opportunities pass by. It is of the essence of European industry's long-term competitive position that the opportunities which do arise for new products involving new markets and new technologies have to be taken.

This is why, in its most recent proposals the Commission envisages a European Strategy for information technologies. You will find these set out in the report which was presented to the European Council in Dublin last December on "European Society confronted with the challenge of information technologies"(1).

(1) COM (79) 650 final.
Modern Europe society is already an "information society" and a new family of electronic technologies is transforming the way information networks work, reducing the cost of information enormously and transforming office work and industrial production in the process.

This is brought about by digital coding in telecommunication, by new transmission techniques such as satellites and optical fibres and by the processor or "chip".

Europe will have to apply these technologies on a vast scale. Many people will have to change their jobs as a result. There will be an enormous need for retraining.

The market for these technologies is enormous; it is growing most rapidly in Europe:

The world market for telecommunication is 26 billion EUA per year:
Europe represents one third. For computers it is 45 billion EUA:
Europe accounts for 30%. For micro components it is 41 billion EUA:
Europe, 25%.

But European industry, whether European owned, or manufacturing in Europe are far behind this rapidly growing market: 16% of the computer market: a quarter of the peri-informatics market. We import 80% of our requirements for integrated circuits!

To respond to this situation and turn back the unfavourable trend the Commission has described in detail a Community strategy:

- to influence attitudes throughout society to favour innovation and change;
- to use the Community's powers to integrate the market for these products;

- to promote the European information industry;

- to encourage cooperation between industry and users;

- to apply these technologies in the Community itself;

- to enhance programmes for satellite communications.

Here at least is a comprehensive, high priority programme for filling one of the major technological lacunae in European industry.

These proposals are a test for all concerned:

- for the Governments, who have to take political decisions, both in the Council and with their own departments - especially telecommunications;

- for industry, which has to rise to a monumental international technological challenge;

- for working people and trade unions to respond flexibly and constructively to the inevitable;

- for the Commission, which will have to implement a major work programme - which does not go without saying either.

I hope this will be a turning point both for industrial policy in the Community and for the industrial economy in Europe. Because if we do not succeed in breaking the trend and turning the tide, the industrial prospect for most of Europe is, as I think I have shown you, bleak indeed.