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## **AN EXPERIENCE OF DEINDUSTRIALISATION - LESSONS FROM BRITAIN'S INDUSTRIAL PERFORMANCE SINCE 1960**

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### **Introduction<sup>1</sup>**

My argument in this paper is fivefold: firstly, that Britain's industrial performance since 1960 has been relatively poor; secondly, that the resulting deindustrialisation is a serious problem for the whole economy; thirdly, that these problems were not solved in Britain in the 1980s; fourthly, that the key reason why British industry has been doing relatively poorly has been underinvestment in manufacturing; and fifthly, that although the specifics of the British and South African situation are very different, there are some analytical points relevant to both, such as the way in which a weak traded goods sector can have multiplier effects<sup>2</sup>. This underinvestment has been allowed to persist by the lack of any strong modernising forces within British society, with the trade union movement having been either too weak or too defensive, and with government policy at best being rather ineffectual and at worst positively harmful. The reasons for this policy failure lie in Britain's economic history and in the resulting distorted nature of both the economy and society. This fundamental problem, of a lack of any strong modernising force, has if anything been exacerbated since 1979. I attempt below to draw out the lessons which the British experience may have for South Africa.<sup>3</sup>

### **The output and employment record for UK manufacturing**

Firstly, some facts and figures: manufacturing output in Britain is barely higher today than it was 20 years ago<sup>4</sup>. Looking at three peak-to-peak periods, in two of them Britain was at the bottom of the league table in terms of output growth of the six countries, and in the third only France had a worse performance. Between the peak years of 1964 and 1989, the average annual growth of manufacturing output was 6.6 per cent in Japan, 3.9 per cent in the USA, 3.7 per cent in Italy, 2.9 per cent in France, 2.7 per cent in Germany, and only 1.5 per cent in the United Kingdom. Over the ten year peak-to-peak period 1979-89,

manufacturing output grew by a total of only 15 per cent, an average cumulative growth rate of barely one percent a year (before dropping back in 1992 to around the same level as it had been in 1973). This poor record on manufacturing output resulted in a marked decline in employment. But does it matter that the 1980s growth was so skewed towards services, particularly financial services, and the construction of shopping malls for the sale of what were increasingly becoming imported manufactured goods?

### **Can deindustrialisation seriously damage your wealth?**

I would argue that deindustrialisation can indeed seriously damage your wealth, due primarily to, firstly, the continued importance of world trade in manufactured goods and secondly, because of the symbiotic relationship between the manufacturing and service sectors.<sup>5</sup>

The emergence of mass unemployment in Europe over the past 20 years has been accompanied by declines in manufacturing employment, and in this process Britain has shown the lead. The share of employment in manufacturing fell in the decade 1976-86 from 22.8 per cent to 19.1 per cent in the US, from 25.5 per cent to 24.7 per cent in Japan, and from 28.9 per cent to 24.4 per cent for the EU. This relative decline represented an absolute fall for Europe, of almost 5.5 million jobs. Of the (then) 12 Member States, only Portugal and Greece avoided a fall in manufacturing employment, with the United Kingdom experiencing the most extreme cut (of 16 per cent, representing more than two million jobs).

A shift in employment from manufacturing to other sectors could simply be the result of a shift in consumption patterns away from manufactured goods towards services, or changes in the pattern of international trade specialisation. However, two important points are clear: Firstly, the decline in manufacturing employment in the United Kingdom *cannot* be explained solely by shifts in consumption patterns, nor by other sectors' requirements for labour: the loss of manufacturing jobs has been accompanied by a deficit in manufacturing trade and by a rise in unemployment; manufacturing has not experienced rapidly rising output as a result of productivity growth, but on the contrary, a stagnant trend in output, with the productivity growth hence translating not into output growth but instead into job losses. And secondly, an economy's distribution of output (and employment) between sectors can lead to balance of payments constraints, and hence can impact not just on relative shares of output and employment but also on absolute levels.

Deindustrialisation also creates conditions in which firms cut back on training. This may take the form of a reduction of in-house training and/or a decline in support for external provision by training agencies so that the local infrastructure

for skill generation is weakened. This leads to a focus on a narrow range of specific skills to meet the firms' immediate needs, often accompanied by the exclusion of worker representatives from the training design and implementation processes. The skill content of jobs is diluted and this interacts with the deterioration of the terms and conditions of employment and the increasing pessimism about future prospects of the industry to discourage new entrants from traditional areas of recruitment. Any subsequent relaxation of hiring standards to meet the labour shortage serves to further reinforce the downgrading of the job, the dissipation of skills, the loss of competitiveness, and industrial decline.

### *Balance of Payments*

Despite assertions to the contrary the balance of payments does matter, and the loss of Britain's manufacturing trading surplus in 1983 and the subsequent annual trading deficit in manufactured goods does pose problems for the wider economy. The service sector cannot solve Britain's balance of payments problems alone.

### *Deindustrialisation can seriously damage your wealth*

So deindustrialisation can seriously damage your wealth: Firstly because much of the service sector itself will depend on the size and rate of growth of the manufacturing sector; secondly, processes of cumulative causation can lead to a spiral of relative decline which can spread out from manufacturing to other sectors, so that for example if deindustrialisation creates a depressing environment for training, this will obstruct one of the very processes necessary for any successful shift into new sectors; and thirdly, a deteriorating position in manufacturing trade creates a number of dangers, not least the deflationary macroeconomic policies which tend to follow any resulting balance of payments deficit or pressure on the currency. And certainly overall output - as well as manufacturing output alone - has lagged in the UK. But does focusing on output levels cause us to overlook a productivity miracle which could be said to have turned the situation round in the 1980s?

### **The 1980s: miracle or mirage?**

Certainly, manufacturing productivity grew in the 1980s, but firstly, this was largely due to job cuts rather than increased output, and these jobs were not being lost in a period of full employment when the labour would be taken up productively elsewhere. Secondly, some of the increased output per person was actually due to a one-off increase in labour inputs per person through increased production-line speeds, reduced break times and so on, not acknowledged in the

official productivity calculations which would only notice the increased output. Thirdly, the official productivity figures are constructed using a single price deflator for both output and input prices; when the appropriate deflators are used, labour productivity growth is lower, at only a 34 per cent rise between 1979 and 1989 rather than the 51 per cent increase shown in the official figures. And fourthly, what productivity growth there was went disproportionately into increased profits rather than reduced output prices (which would have allowed increased market share, with higher output and employment than was in fact experienced, along with a healthier balance of payments and lower inflation), and the increased profits went disproportionately into dividend payments rather than investment.<sup>6</sup>

So while productivity growth in the 1980s returned perhaps to the rates experienced in the 1960s, firstly, these rates of growth were never satisfactory, secondly, UK productivity levels still lag behind the other leading industrialised countries, and thirdly, in the 1980s the benefits of this productivity growth went overwhelmingly into cutting employment and increasing dividends rather than developing new products and expanding output.

### **The causes of deindustrialisation**

Manufacturing employment has fallen fastest in Britain because output has failed to grow. Output has failed to grow because investment has been relatively low; the stable ratio of gross investment to output is the result of inadequate investment (including underinvestment in skills-formation) matched by stagnant output. And manufacturing investment has been low because of the distorted nature of the British economy, combined with bad or nonexistent macroeconomic and industrial policies.

#### ***Under-investment***

The relatively stable ratio of manufacturing gross investment to output disguises two very damaging processes. Firstly, the stable ratio reflects sluggish growth of both output and investment over the long run while other countries have seen rapid growth of both output and investment. But secondly, the impact of the poor and erratic investment record has been to leave UK manufacturing with an inadequate capital stock. This is due not only to the scrapping caused by the severe recessions of 1979-81 and 1990-92, but also due to a reduction in the service life of many capital assets.

During all three peak-to-peak periods the growth of the UK's manufacturing gross capital stock has been inferior to that of the other major industrial nations. This is most evident during the 1979-89 period, when although there was a

worldwide slowdown in the growth of manufacturing investment, the United Kingdom was the only country of the five not to experience any growth in the manufacturing capital stock. This has left a legacy of a relatively low level of capital in UK manufacturing. Capital per worker hour in the United Kingdom is approximately three quarters of the American, German and French levels.

In addition to a lack of investment, much of what has taken place has been cost-cutting rather than capacity enhancing. Thus while for the vast majority of OECD countries the growth rates of both total and industrial R&D were much higher in the 1980s than in the 1970s, the most notable exception to this was the United Kingdom. The dismal investment record of UK manufacturing has been a major cause of Britain's indifferent growth performance, constraining technological progress and the expansion of demand<sup>7</sup>. Furthermore, the cumulative effect of this record has resulted in British workers lacking the volume of capital equipment used by their main competitors. This capital stock gap is likely to grow as, through cumulative causation processes, the expectations that the manufacturing sector is not investing become self fulfilling.

### **UK Macroeconomic and Industrial policy**

UK macroeconomic policy has resulted repeatedly in an overvalued exchange rate and high interest rates, both of which are particularly damaging to manufacturing, while industrial policy has been ineffectual, with little attempt to use the public sector as a modernising force.

The most obvious cases of Sterling being overvalued as a result of macroeconomic policy were firstly, the effects of the Thatcher Government's initial monetarist policies in 1979-80 and secondly, membership of the Exchange Rate Mechanism at an overvalued rate. The industrial policies of the 1964 Wilson Government were also sacrificed on the altar of defending the currency, as were those of the Callaghan Government in 1976; the former was a case of defending an existing parity, while the latter was a fear that the currency would collapse (although whether our trading partners would have really allowed us to gain the competitive advantage which would have accrued to British industry from this is doubtful). In both cases you had a government committed to - and implementing - supply-side industrial policy measures but eventually undermining these with restrictive demand-side policies. To be fair, the mismatch between the demand-side and supply-side was seen by these governments as having been forced on them by international pressures. There is no such excuse for those - of whom there are many at present, in Britain and South Africa - who claim to be supportive of expansionary supply-side industrial policy measures but who from the outset are prepared to hand over responsibility

for important demand-side policy action to unaccountable central bankers.

More recently in Britain the high levels and volatility of interest rates have discouraged investment and business confidence. This was particularly apparent during the early-1980s when high interest rates created cash flow problems for many companies leading to bankruptcies and plant closures as well as contributing to the appreciation of sterling and the squeeze on exports. Interest rate policy during the 1980s has been identified as the main government policy which has impeded the growth of firms. The 1991 Cambridge survey into business performance, the most extensive since the 1971 Bolton study, indicated that a third of all firms surveyed identified interest rate policy as the most important negative government policy and half placed it in their top three policy concerns.<sup>8</sup>

The instability to which the UK economy has been prone, particularly since 1979, has been worse than that experienced in other industrial nations, reflecting the UK Government's desire since 1979 to target nominal variables (inflation and interest rates) rather than real variables (jobs and output). Additionally, they have harmed the long-term growth potential of the economy. This is due to two factors: Firstly, the depth of the recessions - they were much deeper than previous (at least pre-1974) post-war recessions - and the shortage (and high cost) of funds led to large scale scrapping of capital and the laying-off of workers.<sup>9</sup> Secondly, as the domestic economy has, albeit falteringly, developed, the industrial structure has shifted to more segmented and niche product markets. These sectors require specialist capital equipment and sector-specific skills. The loss of such factors due to a recession may be more difficult to replace in a period of recovery. The existence of sunk costs means that restarting operations will be expensive requiring a higher yield (in excess of the required or 'hurdle' rate) to encourage the replacement investment. The long-term costs of recessions place an increasing premium on achieving economic stability in the real economy. The manufacturing sector, like many other areas of economic activity, is not like an elastic band which can sustain severe pressure. When put under stress it will break, or at least parts of it will, and the costs of repair will be large.

But the experience of both Conservative and Labour governments shows that the causes of the British economy's relative decline over the last century or so - the dominance of financial interests, the overseas orientation of British capital, its resistance to government guidance, the culture of short-term profiteering - cannot be overcome by exhortation and incentive. Big business has been peculiarly resistant in Britain to even the most generous curbs on its independence or attempts to point it in a more productive direction. The 1960s and 1970s were littered with the failures of such projects - from George Brown's

National Plan of the mid-1960s to Edward Heath's U-turn Industry Act of 1972. British capital has very strong structural interests in carrying on as it has in the past, which is one reason why the more successful economic regimes operated in countries such as Japan, Sweden, or Germany cannot just be transplanted by a well-meaning British government.

### *The causes of poor policy*

So part of the blame for Britain's poor relative industrial performance lies with inadequate macroeconomic and industrial policy; but this begs the question of why these have been so poor? The answer lies at least in part in Britain's historical legacy and in the resulting power of the City of London.

The historical legacy with which UK manufacturing has had to contend has included a continued overseas orientation not only of the financial sector but also of Britain's multinational corporations; a disproportionate burden of military spending and the distorting effect this has had on R&D; and the continued inability of successive UK governments to modernise the economy. One additional, particular manifestation of this legacy has been the role of the City of London in the functioning of the economy and in the formulation of policy.

The power of the City of London creates a political problem which needs to be taken into account in any discussion of economic policy, namely that there is disproportionate pressure put on any UK government to accept financial orthodoxy and the general interests and demands from the City. The idea that a repeated loss of competitiveness can be rectified by continual devaluations fails to recognise that the former problem will not necessarily be followed by the latter solution; the history of British industry is littered with examples of an overvalued exchange rate, and each time the voice of the City has been loud and clear, in favour of 'defending the currency' - from the 1920s Gold Standard, to the pressure on the Wilson Government not to devalue, to the Callaghan Government's turn to the IMF, through to the UK's membership of the Exchange Rate Mechanism. Hence the importance of taking into account the political and institutional context in which economies are situated and in which governments act (or do not). The argument that Britain's industrial performance is hampered by a short-termism fostered by the City has been made many times, but as good a summary of the case as any would be as follows:

I do not doubt for one moment that deep-seated short-term attitudes are prevalent in our affairs; or that this is one important strand in understanding why we as a nation have performed less well than many of our competitors. Such attitudes have led us to invest less than we might in technology



and advanced means of production. They have encouraged growth in companies by acquisition and financial engineering rather than through organic development and building on products and markets. They have led us to place far too great an emphasis on comparisons of near-term financial results in judging our companies, instead of considering the strength of management and its underlying strategy. Those attitudes are all of a piece.<sup>10</sup>

### **Lessons for South Africa**

The relative lack of dynamism of the British business sector (the term 'entrepreneurial' sector would actually appear rather odd in the British context) may have parallels in South Africa. Certainly there are differences across sectors and over time, and the peculiar history of South Africa (with apartheid, sanctions and so forth) itself shaped the nature and characteristics of the domestic business class (as well as of course being shaped by that class). Specifically, the relatively low rates of investment in South Africa during the 1980s were perfectly understandable given the circumstances, but the business class alone appeared unlikely to itself overcome those constraints, which required firstly the abolition of apartheid and secondly the necessary redistribution, reconstruction and development which a new phase of increased investment and growth would require. On the other hand, unlike in Britain, the other two sectors of the economy which in other countries have provided a modernising force - namely the state, as in South Korea, or the organised labour movement, as in Sweden - did hold out the promise of playing such a role.

In the case of organised labour, the operation of the apartheid regime had inadvertently created an organised force of resistance which was explicit about the need to go beyond such resistance, to break down the old regime, and to see through a transformation of the economy and society. This would take the form of replacing the Apartheid Government with an ANC Government which would redistribute resources including where necessary by the use of nationalisation. The evidence to date is mixed, but certainly the sort of dramatic progress implied above has not been forthcoming. The immediate reason for the difference between the expected scenario of growth through redistribution and actual developments lies in the nature of the transition being one borne out of negotiation and compromise, including the acceptance by the incoming Government (initially of National Unity and latterly of the ANC) of the so-called 'sunset clauses'.

We have argued elsewhere (Michie and Padayachee, 1997a) that in the process

of negotiations, certain concessions were made by the ANC in respect of economic issues which, however important they may have been to the political settlement, did serve to blunt the movement's economic weapons, close down certain policy options, and slow down the process of transforming the institutions, structures and personnel so crucial to a successful economic transition. Some of these stem from the constitution itself, others from what may be termed the 'culture of compromise and reconciliation' which characterised political negotiations. Both the letter of the interim constitution and the climate of compromise and reconciliation politics which surrounded its making, did in some important ways proscribe and restrict the power and capacity of the new government in respect of economic policy and has certainly prevented it playing the sort of modernising role which had previously been generally envisaged.

The key policy issues which, in our view,<sup>11</sup> have dominated policy implementation and the policy agenda during this period include, firstly, *maintaining an orthodox economic stabilisation package*: monetary and fiscal conservatism has been employed to bring down even further the inflation rate, government spending, and the deficit to GDP ratio. Secondly, *rapid trade liberalisation*: proposals announced in 1995 for the motor and textile industries, for example, proposed major tariff cuts by the year 2003, giving manufacturers just eight years to adjust to such a free trade environment but with little or no state support for the necessary restructuring, rather than the 12 years agreed to by WTO/GATT. Thirdly, *restoring industrial peace and labour market stability*: the new Labour Relations Bill absorbed an enormous amount of the energy and negotiations skills of Labour Minister Tito Mboweni and his team for a year. Fourthly, *competition policy*: which initially included a bewilderingly confusing and complex set of sub-issues related to the promotion of small and medium-sized business, affirmative action, black economic empowerment, and an attack on the major South African conglomerates for not doing more to encourage foreign investment and strengthen local black business. It remains to be seen how vigorously the government pursues competition policy as a key element of its overall strategy in a context in which black-owned conglomerates are rapidly becoming a force in the South African economy. And fifthly, *privatisation*: long regarded as strong opponents of privatisation, the ANC, despite continuing objections from its trade union allies, appears to have decided that privatisation may deliver major benefits. Internal debate about what state assets would be privatised, how this would be done, and for whose benefit (black business, foreign investors, the state) continued even though at its 1995 conference the ANC came to accept the need for privatisation 'in principle'.

As indicated above, the experience of privatisation in Britain has certainly not

been one of increased investment, output, and employment. Increased regulatory mechanisms have had to be established to deal with the various problems which have resulted from privatisation in terms of service delivery and combating the effects of private monopolistic and oligopolistic behaviour, but this has not amounted to any coherent industrial policy. In South Africa by contrast there has been an attempt to develop a modernising industrial policy but the slow pace of transformation in the state institutions responsible for industrial policy co-ordination and implementation have hampered this process (on which see Fine, 1997, and Fine and Rustomjee, 1996).

COSATU has implicitly criticised the Government for beginning to embrace a neo-liberal economic policy framework. However, these criticisms have remained largely piece-meal, fragmented and cautious. It remains an open question whether the South African trade union movement will be able to take the initiative to force through a modernising agenda on business and the State, as was done for example in Sweden in the 1930s - a process whose momentum was maintained for several decades without a break.

The constraints on COSATU and the South African Government are perceived to be wider than just the domestic ones referred to above, since global markets also impinge. On the other hand inward investment is seen as a potential benefit to developing the economy. The nature of the global constraints on South Africa are considered in detail by Harris and Michie (1997) where we argue that these do not necessarily prevent policy action; indeed the sort of fractured globalisation which actually exists presents opportunities for policy activity. But the hope that the fact of globalised capital markets would allow South Africa to be modernised via inward investment has proved sadly over-optimistic. There has been very little such inward investment despite an inordinately large effort to attract it. A more appropriate approach to international constraints would be to recognise the balance of payments as the key macro-economic balance which the country has to address and to do so via an appropriate industrial and macroeconomic policy (on which, see Bell, 1997).

And here certainly there are lessons to be learned from the UK experience; despite protestations to the contrary, the balance of payments does still matter. Industrial policy to improve the trade balance can thus have a multiplier effect in raising economic activity more generally, as this constraint is eased, including on Government monetary and fiscal policy. Otherwise there is a danger of increased interest rates to protect the currency choking off investment which leads to a deteriorating trade balance and downward pressure on the exchange rate, and so on.

## Conclusion

The idea that the UK economy will be able to flourish internationally in the future, in the absence of a strong manufacturing sector is yet another in a long line of short-term attitudes to Britain's economic performance and prospects. To return to a position of full employment on a sustainable basis will require a dramatically better industrial performance than that currently witnessed. Indeed, in many ways the situation has deteriorated since 1979; net manufacturing investment which had averaged £3,514m a year over the 1964-73 peak-to-peak period, and £2,146m a year over the 1973-79 period, plummeted to a mere £694m a year between 1979 and 1989<sup>12</sup>. The manufacturing capital stock suffered as a result, and however hard the remaining workers in manufacturing were worked, they could not make up for the loss of capacity.

## NOTES

1. An earlier version of this paper was presented at a workshop on industrial/trade policy in South Africa at the University of the Witwatersrand, Faculty of Commerce -Department of Economics on 6th December 1996. I am grateful to Professor Merton Dagut and Professor Harry Zarenda for commissioning that paper, to Professor John Sender and Dr Ha-Joon Chang for comments, and to Professor Vishnu Padayachee for discussions over the past two years of collaborative research as well as for comments on this paper as first submitted to Transformation.
2. More detailed evidence and discussion in support of these arguments than can be reported in this brief paper can be found in Kitson and Michie (1996a, 1996b). I am grateful to my colleague and co-author Michael Kitson for being able to draw on this joint body of work.
3. The political economy of South Africa's economic policy agenda more generally is analysed in admirable detail by the various authors in Michie and Padayachee (eds)(1997).
4. This and the following assertions are backed up in detail in Kitson and Michie (1996a) and Michie and Grieve Smith (eds)(1996).
5. One of the main differences between the British and South African contexts is the importance in the South African economy of what Fine and Rustonjoe (1996) characterise as the Minerals-Energy Complex (MEC); thus in the South African context there may be a danger in emphasising the importance of manufacturing of downplaying the importance of this MEC (see Fine and Rustonjoe, 1996, p7).
6. The following report is typical: 'Among appropriations, dividend payments rose by 17 per cent in 1990, a lower growth rate than in the preceding two years (27 per cent in 1989 and 33 per cent in 1988), but one that was still surprisingly rapid. The dividend payout ratio, defined as the ratio of dividend payments to total income after deducting tax and interest payments, rose to 56 per cent in the fourth quarter of 1990 and 64 per cent in the first quarter of this year.' (Bank of England, Quarterly Bulletin, August 1991, p364).
7. The important two-way relationship between investment and demand is overlooked in many recent discussions of economic growth which ignore demand constraints on the level of

- economic activity. Investment can increase, as well as respond to, the level of demand.
8. In the Cambridge survey firms were asked to identify which government policies hindered or helped their business in the previous ten years. Overall, firms believed that government policy had hindered their performance. What was noticeable was the high proportion of firms that considered that they had received no help from government policy during the past decade. Nearly a third of the firms surveyed did not identify any significant help from government policy during the past ten years.
  9. The contrasting impacts of mild versus deep recession can also lead to contrasting productivity changes. With mild recessions we tend to observe 'Okun's Law' with a short-term productivity loss associated with a fall in output. With deep recession we observe a 'shock effect' with a short-term gain in productivity due to the shedding of labour and capacity.
  10. Michael Heseltine, Conservative Government Cabinet Minister (then President of the Board of Trade and at the time of writing - April 1997 - Deputy Prime Minister).
  11. See Michie and Padayachee (1997a).
  12. Figures at constant (1990) prices; see Kitson and Michie (1996a) Appendix, Figure A4 and Table A5.

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