IMPLICATIONS OF THE INTERNATIONAL DIVISION
OF LABOUR ON THE EUROPEAN COMMUNITY
Royal Institute of International Affairs (Chatham House)
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IMPLICATIONS OF THE INTERNATIONAL DIVISION OF LABOUR ON THE EUROPEAN COMMUNITY

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The Changing International Division of Labour

by Paolo GUERRIERI and Giacomo LUCIANI

This is a summary of a research project carried out by the Istituto Affari Internazionali, commissioned by the Confederation of Italian Industry.

NATURE AND ORIGINS OF THE CRISIS

The economic growth achieved by the industrialized countries over the last quarter of a century has been exceptional in character. It was made possible by the existence of an international economic order conceived so as to foster trade and a growing degree of inter-dependency between different economies. The export sector has played a leading role in all economies.

Nevertheless the growth of the international economy has had unequal effects on the industrial development of individual countries. It has made it possible to achieve exceptionally rapid growth at a global level and at the same time a significant but geographically restricted redistribution of industrial activity. Similarly the process of multinational company development, another characteristic feature of post-war economic evolution, originated in the redistribution of industrial activity and at the same time tended to strengthen the trend towards this redistribution.

The differential development of industrial sectors in the various economies determined an embitterment of conflicts of interest within the group of industrialized countries; these countries' behaviour became more competitive.

At the same time, conflicts between the advanced countries and intense competition between multinational companies have increased the bargaining power of the non-industrialized countries, and especially of those which produce raw materials. OPEC is emblematic of this trend.

If these are the long range causes of the international economic crisis of the 1970's we may identify the short term causes in violent shocks in the relative prices of a number of basic products. These, in the last few years, have led to the phenomenon of the well known "stag-flation". This implies that the productive sector has not been able to adapt itself to the new structure of relative prices, since certain products are no longer easily obtained as in the past. In other words, the structural imbalance between supply and demand makes it necessary to change the composition of demand (that is of overall demand and not just of final demand).

This involves changing productive technologies as well as supply. To date the distribution of income between and within individual countries and the structure of their productive apparatus have created a whole series of obstacles to this kind of change.

For this reason we argue that growth today is being limited above all by changed conditions of supply. It is the need for a reorganization of production so as to induce a high degree of compatibility between supply and demand that places a constraint on growth in world - wide manufacturing value added. We are not seeking here to credit the argument that there exist 'absolute' limits to growth. It is however clear that there do exist limits on the rate of industrial growth which can be achieved at any given time and that these limits are inherent in a system's industrial structure. The fact that the productive system has to adapt itself to the new structure of relative prices implies 'coeteris paribus' a reduction in the maximum growth that system can permit. The maximum possible growth rate could be raised if these were full cooperation at an international level. So long as there is no agreement as to how to share the advantages, this kind of cooperation is unlikely.

Consequently not all countries will be able to attain the growth rates for which they aspire. Increased real growth in some areas necessarily implies a slowing of growth in other areas. The logic of the above reasoning induced us to use a 'supply oriented' model for our analysis rather than the traditional Keynesian model. Only the former is consistent with our interpretation of the economic crisis of the 70's.

The fact that the majority of variations in relative prices may be traced directly or indirectly to unresolved conflicts in international economic relations justifies the primary statement of this paper that the economic order which emerged in the immediate post-war period at an international levelis no longer valid. To evaluate the main implications of this crisis on the balance of the international division of industrial labour, we deemed that it was necessary to start our discussion from the new economic order which the group of 77 is claiming from the OECD countries. The question to ask is why the OECD countries should accept the G77 requests and collaborate in the building of a new economic order. We tried to answer pointing out, on the one hand, the existence in the old order of certain variables at least partially under the control of the G77 (oil supplies, indebtedness and commercial pressure) which could be used as a weapon against the OECD countries and, on the other, the need for the USA to maintain a certain degree of hegemony and strategic control at a world level. Let us consider these factors in order.

Elements of Pressure on the Existing Order

The so-called 1973-74 "oil crisis" had politicalrather than physical origins, in the sense that there was a quantity of raw materials which were physically available and sufficient to meet world demand.

In the next ten or fifteen years however a new and more serious crisis could take place, this time because of physical scarcity rather than political reasons.

The unanimity of all the specialized forecasts for energy consumption and for production and reserves is worthy of note: these diverge in the short-term determination of the probable crisis point (about 1983 being the most pessimistic point, and the more optimistic in the early nineties), but they agree upon the forecast of a crisis point. In addition, the situation of energy policies in the OECD countries does not offer much possibility for doubt: a significant reduction in dependence on oil would require a considerable effort and a higher degree of international cooperation. Neither unfortunately seems to be forthcoming. Unless we hypothesize dramatic efforts at energy conservation and the development of alternative energy sources, energy is bound to act as an upper limit on the GNP growth rate that can be achieved by the OECD countries. Individual countries could achieve higher increases, but in our "supply model" logic this presupposes that others will experience lower increases.

Obviously, the availability of oil, besides being a limiting factor on the attainable rate of GNP increase on the part of OECD contries, is also a bargaining weapon which the G77 countries can use in negotiations with the OECD countries. It is a weapon in itself, in the sense that there could be a new total or partial embargo for either a short or lengthy period. Above all, however, it is an indirect weapon, i.e. through its financial and industrial implications. The financial implications are likely to become more and more serious, because in every case, the income of countries with a low internal absorption capacity will tend to increase. The level of tension that this could cause on the Euromarkets is worrying.

In recent years the banks which work on these markets have seen a very rapid increase, both in the inflow of public money (primarily from a number of OPEC countries) and in the granting of credit to governments or other semi-official bodies. The exposure of some of the G77 countries has increased very rapidly, while the total debts of the G77 countries have more than tripled. The greater part of this increase has been covered by the banking system and has been directed towards a small number of countries.

The indebtedness of the G77 countries has reached such dimensions and characteristics as to put significant pressure on the present economic order. This largely depends on the high concentration of debt from a few countries, and on the non-regulated nature of the Euromarkets, and in particular, the absence of a lender of last-resort. Even if a declaration of insolvency by an important country is unlikely, the high degree of indebtedness of several countries adds a further element of conflict and tension to the international setting.

Furthermore, we have to consider that this high indebtedness forces certain countries to follow development policies geared to exports towards OECD countries. In the course of the 70's several G77 countries which had followed an export-led development strategy in the previous decade, increased their commercial penetration of markets in industrialized areas. Other countries are following their example. The phenomenon is still limited, but in the future, it could assume larger dimensions, causing deep modifications in the industrial structure of many OECD countries, and aggravating conflicts among countries in the OECD.

Commercial pressure on internal OECD markets is a different kind of weapon in the hands of G77 than the two we have discussed so far. It is clear that the OECD countries could easily defend themselves from this pressure through protectionism. This however would mean more than simply abstaining from conceding favourable conditions. The adoption of protectionist measures by the OECD countries would constitute a clear act of economic hostility whose consequences would go against the strategic interests of the stronger OECD countries in general and the United States in particular. Commercial pressure is thus a weapon which forces the OECD countries onto the defensive, obliging them to look for an alternative solution to protectionism.

The Role of the United States of America

To the reasons above, which necessitate a move towards a new international economic order (the vulnerability of the OECD group in energy, tensions on international financial markets, commercial pressure from certain countries of the 77), we should add America's desire to maintain at least a certain minimum degree of political hegemony and strategic control over several countries of the 77.

Within G77 not all countries hold the same weight : on the contrary, there are a limited number of key countries which compete for hegemony in the various regions and even within G77. This group of countries carries considerable weight from an economic point of view. Their political goals are today very diverse; it is a certainty however that the stability of their respective governments could be placed in question by a lack of economic development. This development is mainly linked to a different and deeper economic integration with the OECD countries.

A 'hard-line' position by the USA on the new economic order would therefore, significantly influence the political equilibria between these countries, as well as their domestic political balance leading to all kinds of destabilizing factors at a global level. At the same time it is essential to consider the danger of war between G77 countries, if there is no progress towards a new order. This would almost certainly end up by creating new openings for a growth in Soviet influence.

The United States cannot then sustain a position which entails a complete rejection of the G77 requests. This is for political reasons rather than economic ones and implies that the USA should find a compromise between the need to meet the demands of internal public opinion and the need to maintain a global presence. This presupposes at least a partially positive response to G77 demands. Everything indicates that this compromise can only be reached at the expense of other countries in the OECD area, increasing the probability of conflicts within this area at a commercial but above all at a monetary level. Our argument is that we will witness a gradual and systematic depreciation of the dollar in terms of the other principle currencies and in particular the Yen and the Deutschmark.

In the logic of the 'supply oriented' model, used in our paper, the chances of avoiding conflicts within the OECD area are linked to a series of conditions. The first of these is that the United States accepts a lower real growth rate or, alternatively, a pronounced change in the composition of national income. A slacking of growth in the United States would strengthen the trade balance and would substantially improve the international energy balance. The consequent reduction in world aggregate demand could be countered with a simultaneous increase in the rate of growth in the rest of the OECD, which, after all, is the reason why it is desirable to reduce growth in the USA. Nonetheless harmonic scenario also requires a wide ranging strengthening of international institutions, so as to allow a substantial expansion of lending and development aid, new forms of technology transfer and industrial cooperation and international control over the multinationals. These proposals are not new; undoubtedly they would allow a solution to conflicts within the industrial area. It is however a fact that there has been no significant progress towards the development of international institutions. The reason is not only the traditional argument that the USA sees a threat to its international position in any such development of international institutions, but also US domestic economic policy. As a matter of fact an 'internationalist' solution would only be valid if earlier in the process, there were a decision in favour either of lower domestic growth, or, at any rate, a different quality of growth in the USA. These last two choices clash with the goals of groups playing a fundamental role in the American political balance.

If this choice is not made, the other OECD countries would have to accept a reduction in growth. The alternative result, if all the OECD countries reflate their economies simultaneously would be a higher inflation rate without any long run effect on real growth.

It is these considerations which lead us to argue that conflicts within the OECD area are likely to become more intense in the next few years. The fact that for the US Government it is impossible to chose a model of internal development which differs significantly from the present one, means that the USA find it hard to accept a growth of international institutions. Objective conditions are such as to make it extremely difficult to reach a compromise acceptable both to the USA and to all other principal actors.

The Future of European Integration

The consideration of the different factors mentioned in the previous chapter leads one to predict a setting of intense conflict and competition at all levels. Deep shocks to the system are likely to become much more frequent than at present.
It is against this background that we intend to discuss possible developments whithin the European Comunity, and the way in which these could influence the situation described.

To this end, we should begin by considering the so-called 'theory of the three locomotives'. According to this theory a return to higher rates of income growth in the complex of OECD countries requires that the USA, Japan and West Germany adopt reflationary policies. As far as regards the European situation, it is implied that the German position is different from that of other European countries and that it has a determining role for the Community Economy. This implication seems unquestionable, if we consider that the development of trade has led the Community to resemble ever more closely a hypothetical 'deutschmark area'. The key problem with the theory of the three locomotives is however that this theory has the fundamental defect of suggesting the adoption of an attitude directly opposite to the policy hypothesized as necessary in accordance with the picture of the international division of industrial labour depicted in our paper. If the overall rate of growth for the OECD area is to be no higher than 4%, and if the United States, Germany and Japan are to develop at a higher rate, there are only two alternatives: either we oppose the claims of G77, or else we accept that the rest of the OECD area will have an even lower rate of growth. A relatively small German surplus (created through a policy of expansion in Germany) would have the effect either of increasing the real gap between

Germany and the rest of the Community or alternatively leading to a division of labour within Europe where Germany would specialize in the higher technology sectors of production. Germany cannot decide on this alone : it is essential to reach a consensus with other countries, since Germany is not only the strongest country of the Community economically but also the country most open to outside political influence. Even if the usual justification for the German refusal to take up a locomotive role is the fear of hyperinflation, it is our conviction that the Germans are conscious of the fact that a more reflationary economic policy would create political tension and that Germany's European partners would tend to react with defensive attitudes in industrial policy, in terms of subsidies to national producers and market restrictions on German industry.

This is the crux of the problem of the future of European integration. Its solution can only come about through the development of democratic and, at least potentially, sovreign Community institutions. Such institutions would allow the Community to gain the necessary degree of control over German development, and would reduce the problem of German hegemony.

The future of the process of European integration thus depends on genuinely political factors. Specifically economic problems are obviously important; nonetheless, they assume secondary importance compared to the primordial political problem. We must askourselves what the consequences would be on the process of Community integration of a failure to achieve a qualitative leap at the political institutional level. Let us begin by excluding the possibility of Community disintegration. Our point of view in this report is that commercial interdependence between the Community countries has advanced so far that no member country sees it as being in its interest to leave the EEC. At the same time, however, lack of progress at a political institutional level would block substantial progress towards monetary union or towards qualitative improvements in EEC sectorial policies.

In these conditions, the European economy would be deprived of any internal 'locomotive'. The divergency between the relative value of the dollar and the Deutschmark, and between the Community currencies would be perpetuated. This would act as a constraint on the maximum possible growth rates which the member countries could achieve. In practice, individual countries could obtain more favourable results by finding a niche in the American strategy for a new economic order. In this way, however, Europe would no longer have an autonomous role in bargaining between the 77 and the OECD countries, and the European rate of growth would necessarily be significantly lower than in the past, on account of commercial pressure from the new competitors together with Japan, and above all because of the energy constraint.

The only alternative path that the Community could follow is therefore strictly linked with a democratic development of Community institutions. The authors of this report consider that one should not rely on the development of a supranational Community. Considerable steps forwards are possible, beginning with direct elections to the European Parliament. There is however every reason to suppose that by the end of the century, the ideal of an European federation will still be nothing more than an ideal.

Nevertheless, the importance of this aspect of the problem should not be exaggerated; what is important is the overall trend; a process involving even the partial development of democratic European institutions could be adequate to allow a more incisive presence of the Community in many key sectors of economic policy. This moderate optimism is encouraged by the difficulty of the situation which has to be faced. Clearly, this situation is such as to leave little space to national governments, which would be unable to reach favourable results through their own isolated action.

A largely unified Community could also to some extent have an autonomous role in the defining of a new economic order, increasing the potentiality for growth of the member countries. At the same time it must be remembered that a more dynamic Community at the international level might not be welcomed by the United States. Rather all that we have said leads us to think that we will witness more frequent dissent and friction. A negative attitude of the United States could kinder the development of Community institutions, as we have seen many times in the past.

If then the considerable number of costraints which today exists limit the possible future development of the international economy within boundaries which appear to be fairly clearly drawn, the main unknown remains Community integration. An acceleration of integration in the direction we have indicated could substantially modify the situation and reduce tension. Whether this integration is likely is another matter.

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Options for Italy in the New International Division of Industrial Labour

by Paolo GUERRIERI and Giacomo LUCIANI

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P A R T II

OPTIONS FOR ITALY

S u m m a r y

In the context of increased conflicts in the international economy that we depicted in Part I, the position of Italy is not going to be an easy one. Italy is in fact one of the weakest countries in the industrial group. Inevitably, it is going to suffer because of the evolution towards a new economic order: while, in the past, it found itself in a position to take advantage of the expansion of international trade without too much effort, and succeeded in increasing its share of total world manufacturing; in the coming years, it will have to face increasing difficulties on the international markets, while its share in world manufacturing will most likely decline.

In the face of these difficulties, Italy finds itself worse equipped than many other countries: the burden of some structural weaknesses on our economy is very heavy, the dependence on imported raw materials is very high, Italian corporations are latecomers along the road to multinationalization, and mature products account for a significant share in our exports.

At the same time, Italy must strive to reach faster rates of growth than its European neighbours to the North if it wants to fully integrate within Europe. Thus we cannot simply adjust our growth targets and settle for a reduction in our growth rate, while the rest of Europe grows faster, because this would necessarily entail gradual emargination from Europe. We shall have to pursue relatively ambitious growth targets, running against the tide.

Action at the International Level

Although the influence of our country in the international arena is limited, there is some room for independent action.

We feel that Italy should stand in favour of the concept of a new international economic order. Although the evolution towards such a new order will undoubtedly cause problems of adaptation for our industrial sector, the well-being of the population will eventually gain from a worldwide spread of industrial activity.

Also, as it is impossible to revert to the past, Italy stands to lose more in a scenario of intense economic conflict, rather than in a scenario of faster evolution towards a new order.

However, our country cannot be indifferent on the path that the evolution towards a new order will follow.

In particular, we are vulnerable to sudden increases in the price of raw materials, therefore, we have an interest in the negotiation of commodity agreements that would allow for gradual and reasonable price increase (since the terms of trade for raw materials relative to manufactured products will necessarily improve on the average). Also, we have an interest to cooperate in the process of industrialization and economic diversification of the G77 countries, because the likelihood of formation of cartels would then be reduced.

At the same time, we have an interest in seeing most G77 countries opting for a strategy of industrialization geared to the needs of the national or regional market, rather than to exports to the OECD countries.

This is not to say that we should favour protectionist tendencies; rather, we should push for a solution of international financial problems that would make it easier for G77 countries to finance long-run balance of payments deficits.

This means that our country should favour an enlargement in the role of the IMF. Firstly, the lending capacity of the Fund must be increased by more frequent and larger increases in quotas. Secondly, a redistribution of the quotas that would enlarge the potential drawing of G77 countries should be pursued. Thirdly, the Fund should be given some power to regulate the Euromarkets and act as a lender of last resort. Finally, we still think that the role of the SDR in the international monetary system should be increased, and that the allocation of SDR's should be linked in some way to development aid. In the past years, Italy actively pushed in favour of a larger SDR role and of the "link": these proposals were defeated, but they are still valid, and our country should insist upon them.

Action at the EEC Level

Italy is a member of the EEC, and our assumption is that this is an irrevocable political decision. We think that any hypothesis of pulling out of the Community is deprived of practical relevance.

Whatever the evolution of the international economic order, our economic linkages to our EEC partners will be quantitatively essential in determining our position in the international division of industrial labour.

As we have seen in Part I, the transition towards a new economic order will affect the process of European integration. The Community as a whole will become an area of relative slow growth, and this might increase tensions and jeopardize the integrative process. It is essential that the Community be able to develop a common strategy in the face of the evolution of the international division of labour. What is needed is a combination of industrial, social and regional policies such as to allow, on one side, for adjustment to a new international order, and on the other side, for progress in the process of European integration and reduction of distances inside the EEC.

In a Community that grows more slowly than it used to, the ability of our country to reach a better than average rate of growth, and more fully integrate within Europe, very much depends on the acceptance by other EEC members. If the concept that there should be a redistribution of industrial activity within the EEC, in parallel to a redistribution worldwide, is not shared by our European partners, there is indeed little hope that we may achieve our goals against their wishes or in the face of their active resistance.

A process of redistribution of industrial activity within the EEC will not come about by itself. It needs to be stimulated by vigorous regional and industrial policies, encouraging investment in the less industrialized European regions. This is not an obvious choice at a time when a number of industries have to adjust to increased international competitions and a less dynamic internal market. Italy will have to fight a difficult battle to get the approval of other EEC members on the kind of policy package that is needed. However, this is an essential effort, and a failure to win acceptance by other partners could only have disastrous consequences.

Action at the National Level

Italian economic development in the post-war period has been characterized by a growing integration in the world economy. The export sector was highly dynamic and the ratio of trade to GNP has increased consistently.

This was more a result of the fast growth of international trade and of the favourable position in which Italy found itself, at least until the early 60's, than of deliberate and coherent economic policies. Quite often, government policy - especially industrial policy and the behaviour of state enterprises - was implicitly protectionist. Ailing enterprises were kept alive or "infant industries" were nurtured with an excessive spread of resources in too many different directions. This was made possible by the success in exporting of other, better organized and competitive industrial sectors.

In the coming years, a more rational and selective policy will be necessary. In order to maintain an acceptable rate of growth, Italy will need to make a concerted effort to increase its exports. As the favourable conditions of the past are over, and Italy is no more a relatively low cost producer, this goal will need far greater efforts than in the past.

To a greater extent, Italian corporations will be obliged to expand multinationally and create their own marketing structures worldwide. This will absorb both capital and managerial skill. As these are scarce resources, it is of foremost importance that they are allocated to those ventures that can effectively improve our position in the international division of labour.

It is not possible to say a priori if it is more convenient to allocate capital and managerial skill to activities reducing our dependence on imports or to activities fostering our ability to export.

Each case must be considered on its own merit: in some instances, one will find that the evolution of the international market for specific products will make it convenient to protect national production even if it is temporarily non competitive; in other instances, it will be more rational to slowly abandon existing production or renounce entering new fields, and accept the dependence on imports while allocating capital and managerial skill to competitive sectors in order to give them a better chance to expand exports.

In making policy decisions, it is essential to recall that while in the past our industrial sector has grown larger relative to world total, it will now most likely tend to become smaller. Thus, while in the past, one could reasonably assume that Italian enterprises should be active in all industry, in the future the tendency will necessarily be towards greater specialization.

A Policy Towards Multinational Enterprises

To the extent that national capital and national managerial skills are limited, it is very important that they be supplemented through a more advanced policy towards multinational enterprises (MNE).

As Italy is a member of the EEC, we cannot control trade flows in order to condition the behaviour of MNE's. In the past, our country has been viewed by American and European MNE's rather as a market than as a productive base. International investment concentrated in other regions within the EEC, and thus structurally weakened the Italian external trade position. Italy was not considered a convenient location for factories because of the poorer quality of infrastructures and because of lower political stability and more difficult industrial relations. At the same time, government policy, while extremely liberal on paper, in fact, did nothing to stimulate the location of productive facilities in Italy.

A selective policy of encouragement to greater MNE presence in our country is, therefore, needed.

The Issue of Technology

It is often heard that Italian industry should strive to increase the technological content of its production. A word of caution seems necessary, as recent experience proves that technological leadership is not always a guarantee for success. There have been numerous examples of products incorporating a very sophisticated technology that turned out to be commercial failures.

In many instances, imitation has proved to be a superior choice. Once corporations learn to imitate systematically, as by now they do in almost any industry, the advantage that is derived from technological leadership is drastically reduced. Imitation is generally much less expensive and risky than innovation.

Secondly, if indeed it is the markets of the G77 countries that will grow faster in the next two decades, one can reasonably assume that, relative to past experience, the demand for advanced or new products will grow more slowly, while the demand for some mature products might grow considerably faster. To a great extent, this depends on the strategy for industrialization that a majority of G77 countries will adopt. Nevertheless, one may reasonably assume that technological leadership will not be a decisive element in determining the relative share that each enterprise will capture in these fast growing markets.

Adjusting to a Difficult Environment

The adoption of a competitive policy, as has been sketched might lead our economy to a degree of dependence on the outside world that might be considered excessive, or dangerous in view of increased tensions and conflicts in the international economy. The appropriate way to try to reduce the exposure to foreign shocks is to bring about a change in the composition of internal demand. It would be a mistake to support non competitive industrial activities just for the purpose of reducing our dependence on the international economy: to do so would inevitably place a burden on competitive activities and eventually worsen our position in the international division of labour.

But a policy of demand conditionment is certainly needed. The overall rate of growth that can be attained is not independent of the composition of demand. It could be considerably higher than the pessimistic forecasts advanced in Part I if strong action were taken to encourage certain types of consumption, those that do not need large inputs of imported raw materials, while, at the same time, being highly labour intensive.

A reduction in dependency on the rest of the world, that is achieved through a change in the composition of final demand, does not reduce the general degree of competitiveness of the economy. If, on the other hand, the same result were achieved through artificial breeding of non-economic industrial activities, our industrial sector would necessarily become less competitive. And, although the rate of growth under protection might seem to be higher, real income in terms of the purchasing power of the consumer, will be less.

In order to achieve an equitable distribution of income, it might also be necessary to enforce changes in the labour market, such as a reduction in individual working hours. This is preferable than pursuing full employment through standard Keynesian policy, i.e. through relation and an increase in the rate of growth. In simple terms, one might say that in this second case people would work more but they would not be better off.

It is necessary to adjust to a difficult environment. It is also true, however, that this adjustment is possible, and if appropriate measures are taken in time, the outlook for the future is not bleak at all. We would still have a growing economy, our income would increase and we might have a better opportunity to enjoy it.

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An address by A. Mosconi

EUROPE - A MARKET WITHOUT GOVERNMENT:
REQUIEM FOR WEAK COUNTRIES

THREE CASES IN POINT - THE AUTOMOBILE, AIRCRAFT, AND ELECTRONICS INDUSTRIES

Siena, May 25-27 1978

Premise

The economic crisis in Europe, in the absence of adequate political institutions capable of facing up to the problem, is threatening to destroy agreements on the removal of customs barriers. Measures that are more or less obviously protectionist are becoming more frequent in the political-economic programmes of the individual countries ~~in Great Britain, a return to protectionistic theories~~.

The Cambridge school, in particular, has identified a number of common links between mercantilist theory and its partial reinstatement implicit in Keynesian philosophy.

It is no surprise that, in such a difficult phase of international relations, the temptation of protectionism should make itself felt in that England which, when she was at the height of her industrial supremacy, was responsible for exporting the doctrine of Free Trade to the rest of the world. The need for protection is a physiological characteristic of the weak, of children and of the elderly, whereas it is a pretence of the strong that there are no limitations imposed on the exercise of their power. Also, if we look at Italy, in the years following unification, at the beginning of the process of industrialization, we find a protectionist policy in industry (corresponding to the phase of "infant industry") which did not succeed in imposing itself on the free-trade interests of the large landowners, until American competition caused the fall in agricultural prices. Only then did the resulting equation of agricultural and industrial interests bring about a policy of protectionism with the introduction of customs tariffs in 1887. It was not until after the Second World War, when Italy joined the European Economic Community, that trade was once again gradually liberalized, leading to the total abolition of customs tariffs within the E.E.C. in 1968.

The contradictions in the process of integration, and the inability of the individual European nations to compete with the large federated states of continental dimensions, indicates, already today, conditions of weakness that are so grave as to repropose some form, more or less masked, of protectionism also in Italy, a situation that is supported by the continued presence of strong regional inequality.

The effects of European integration on the development of the question of Southern Italy have been amply debated. As far as we are concerned here, it is sufficient to mention the comprehensive conclusions reached by Graziani. The choice of free trade which Italy's entrance into the Common Market entailed, also called for a restructuring of Italian internal production in order to satisfy external demand, "typical of societies distinguished by much higher incomes brackets, and therefore orientated on the whole towards mass consumption and luxury goods..... which are quite out of line with the modest level of the average Italian income". The struggle to win foreign markets meant that priority was given to investments in industry in

Northern Italy which offered greater assurance of succes. "In this way", concludes Graziani, "the decision that was taken to open up the Italian economy to international economic integration, not only had a determining influence on the structure of Italian industry, but led to a crystallization of its territorial distribution".

In the context of the situation described above, the question of Southern Italy represents a typical example of the need to create a political structure for the Common Market.

The negative effects of membership of the Community, pointed out by Graziani, are not in fact due to the actual opening up of the markets, which is, on the contrary, a sign of development, but to the lack of a strong guide, to regulate the market and to eliminate imbalance at a European level.

The weakness of the Community's regional policy reflects the weakness of the Community's executive body, which lacks the legislative power to effect substantial transfer of resources.

This weakness makes it impossible, on the one hand, to recognize a situation of real competitivity between European countries (an obvious example is the automobile industry), and on the other to bring about consistent, realistic developments in fields of advanced technology, as in the aircraft and electronics industries.

The case of the automobile industry

The period of greatest development for the automobile industry was that characterized by the breaking down of customs barriers, and international monetary stability insured by the supremacy of the Dollar. To these basic characteristics there were obviously added others specific to the industry, such as the growing demand for mobility on the part of consumers, rising incomes and the image of a "status symbol" which the automobile had assumed in the Nineteen-Fifties and Sixties.

During these decades the main difficulty facing the industry was the need to satisfy a growing demand in an international economic context which, as far as this sector is concerned, showed the self-sufficiency of the E.E.C. countries and the minimal and non existant competition of the non-Community countries.

The automobile industry went through a peak period, reaching its maximum level of development during the years in which the international division of labour, in this sector, favoured the industrialized countries, among which there existed a situation of relative equilibrium.

ANALYSIS OF WORLD PASSENGER CARS PRODUCTION BY AREA (%)

	1967	1977
EEC	39.1	32.1
Western Europe (extra EEC)	2.8	4.6
North America	43.0	33.3
Socialist bloc	2.7	7.0
Latin America	1.5	3.4
Japan	7.5	17.4
Rest of the world	3.4	2.2
TOTAL	100.0	100.0

The impulse given to the expansion of the market following the establishment of the European customs policy petered out, while the dollar crisis ending with the formal decision as to its inconvertibility, sanctioned the end of the monetary stability which was the basis of the development of trade both outside and within the Community.

The developing countries, in turn, after shaking off the last remnants of colonialism, started to claim for themselves a growing share of the world's riches by increasing the price of raw materials, refusing the rôle of mere suppliers of goods for transformation, and requiring that factories be built on their own territory.

Almost at the same time, the automobile industry starting from the early Nineteen Seventees witnessed the beginning of a new trend towards replacement, rather than first ownership, of motor vehicles, within an international framework characterized by a rapid increase in supply following the entry of new manufacturers coming from the developing countries, the Eastern bloc, and Japan.

Because of the persisting political and monetary weakness in the European Community, the weaker countries have born the brunt of the cost or readjustment under way in the world economy in the wake of international economic and monetary fluctions have compelled the European countries to adopt measures to protect and hold in check internal demand, and this has only hampered the specialization of production in Europe.

We can show at this point some significant examples from the automobile and commercial and industrial vehicle sectors:

ANALYSIS OF PASSENGER CARS PRODUCTION IN THE EEC (%)

COUNTRIES	1967	1977
G.F.R.	32.1	37.9
FRANCE	23.0	30.9
ITALY	20.2	14.4
U.K.	21.7	13.3
BELGIUM	2.3	3.0
NETHERLANDS	0.7	0.5
TOTAL	100.0	100.0

INDUSTRIAL AND COMMERCIAL VEHICLES

(Percentage analysis of EEC production)

COUNTRIES	1967	1976
G.F.R.	20.3	25.7
U.K.	41.9	28.9
FRANCE	26.3	35.7
ITALY	11.5	9.7
TOTAL	100.0	100.0

Not without importance is the fact that the countries suffering from a fall in production share are those having the greatest difficulties with their balance of payments, namely Italy and the U.K., and the have therefore been forced to adopt the strictest measures of restraint on demand, and which have affected the automobile sector in particular. If the measures in support of the nationalized automobile industries adopted by the governments in several countries are added, it follows that the cost of the crisis hitting the automobile sector following the increase in the price of petrol, has been carried over to the weaker countries. The performance of vehicle trading balances provides a sufficiently indicative index of the more aggressive competition on an international level and, above all, inside the Common Market. (Appendix 1)

The index of industrial concentration shows that further sign of weakness in the European automobile industry is clearly to be traced to the division of Europe into national sovereign states.

This is shown by the fact that the three major U.S. car manufacturers account for 97% of the entire U.S. production , while it takes as many as ten European automobile companies to make up 96% of their market. (Appendix 2)

The rate of profit and self-financing is directly related to the index of industrial concentration, and has allowed the U.S. industry to finance its reconversion, made necessary by the energy crisis, whereas investments by European manufacturers are, of necessity, diverted into the battle of model types and the conquest of new markets.

The case in the aircraft industry

The existence and growth of an aircraft industry presupposes a political decision, since it develops downstream from two strategic systems, defence and transport, and requires a considerable financial commitment. To do without an aircraft industry means, however, to do without advanced technology because it acts as a spearhead for other industries, thanks to the technological fall-out and research stimulus it offers. The responsibility for such a decision cannot be made to fall completely on the shoulders of private industry. It is essentially a government matter because it involves:

- long-term planning;
- high technological risk resulting from the extremely high innovation rate;
- the development costs of aeroengines which exceed the capacity of national budgets and have to be undertaken by more than one nation (e.g. the Concorde);
- long engine development times (10 years between definition of the specification and the engine's entry into service) and cash flows with long-term returns.

Once the decision has been made, however, it is still necessary to prove that an aircraft industry can exist at national level, in the case in point, in Italy.

A first comment arises from the dimensions of producer companies: limiting ourselves to aircraft, in 1975

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9 companies in the U.S.A. and 5 in Europe recorded sales of more than 300 billion lire.In Italy no company can claim to match this dimension. In the case of engines too, 4 United States companies recorded sales of more than 300 billion lire and 2 companies did so in Europe, but no Italian engine company attained such levels. Another feature of aircraft companies is the money spent on research: in the United States for example, the expenses incurred by the aerospace industry represent almost a quarter of the R&D expenses of all industries,while in terms of employment figures, the sector occupies little more than 5% of the workforce. In 1971, the R&D expenses of USA aerospace industries exceeded 3.2 million lire per employee,and 2.6 million of this was financed by the American government. In Italy, the expenses sustained by private companies and the State reached 700.000 lire per employee.

A national aerospace industry thus becomes increasingly hard to maintain as far as Italy is concerned and the problem must thus be posed at European level.
Is it worth working towards a European aircraft industry,given the sector's characteristics? The United States account for 57% of total aeronautic sales of countries with non-planned economies, and Europe 33%. Two thirds of world exports of aircraft come from North America and about 20% from Europe, although if we consider engines alone,Europe accounts for 52%, namely more than the U.S.A.

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In market terms, Europe at 35% presents an equivalent absorption capacity to that of North America (36%), the remaining 29% going to the rest of the world. Qualitatively, however, the market is much different to that of the U.S.A. because it is broken up among different countries.

"The action programme for European aeronautics" launched by the EEC in 1975 was aimed at creating the premises for a European industry but remains little more than a collection of good intentions because the political premise is missing.

THE AIRCRAFT INDUSTRY IN THE MAIN INDUSTRIALIZED COUNTRIES

(Turnover in billions of lire)

COUNTRIES	Aircraft manufacturers		Engine manufacturers	
	Employees	Turnover	Employees	Turnover
U.K.	90.500	877	64.082	873
FRANCE	60.315	1.350	22.630	450
GERMANY	32.420	703	6.902	148
ITALY	20.900	330	5.400	97
BELGIUM	3.000	60	1.300	32
NETHERLANDS	7.670	209	-	-
EEC TOTAL	214.805	3.529	100.314	1.600
U.S.A.	275.000	7.359	139.600	1.992
JAPAN	13.615	333	3.430	104

The case in the electronics industry

Electronics is a key sector for the development of any country's productive forces because of its repercussions on the organization and management of the public and private sectors. Furthermore, the rate of capital invested in the sector is already higher than average and is tending to increase because margins for growth are considerable.

Although it is the second biggest market in the world, Western Europe has not succeded in balancing the competitive situation with the United States. If we subdivide the electronics market into three areas: components, consumer electricals, and industrial systems, it will be seen that the U.S.A. holds respectively 42%, 38% and 67% as against Europe's 34%, 36% and 23%.

However, ventures such as the manufacture of a European computer with contributions from ICL, C.I.I., Siemens, Telefunken, Philips and Olivetti, or the Airgrain cooperation project in the sector of components standardization, have failed miserably. The failure of these projects is attributable not so much to technical difficulties, as to the lack of a "European will" on the part of certain of the partner companies, a shortcoming explained in its turn by the lack of support from the European authorities.

In 1974, the EEC took steps to support the information systems industry by passing a measure aimed at establishing a medium-term community programme for the promotion of technological research, industrial development and applications. Had it been implemented, the rôle of

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American competition in Europe could have been limited. Allowance must be made, however, for the limits to co operation between sovereign states, the nature of which is undoubtedly objective, even if the "nationalism" of managers and workers and the lack of adequate strate gies for taking full advantage of the opportunities offered by transnational concentrations have consider able importance. And the part played by the state in supporting electronics companies by way of military or civil, direct or indirect orders, is decisive.

The multinational dimensions of the electronics indus try require heavy concentrations of capital, labour and orders, and the spread-out nature of European countries puts them at a definite disadvantage compared to the United States. So if the European companies cannot break through, the reasons are not to be sought in any intrinsic weakness which they might have, but in the political divisions of Europe. In view of the fundamen tal contradiction between economic dimension and national state, community decisions represent nothing more than palliatives which are quite incapable of breaching Amer ican supremacy in the sector.

Conclusions

It can therefore be concluded that the outlook for the international division of labour and the rôle of the EEC, and of Italy within it, is a function of whether the conditions that have guided European economic development are to be re-established, or whether the path of increasingly outright protectionism is to be pursued.

The European economy will enjoy a future of growth only if it is able to institute its own "virtuous" circle of profit/research/innovation/profit. If it fails, the gap separating it from the United States will become wider and Europe will find itself relegated to peripheral, subordinate rôles.

The institution of a European industrial policy is a sine qua non for re-establishing equitable conditions of competition within the EEC and for creating a more advanced international division of labour with emerging countries. The Industrial Affairs Commissioner, Etienne Davignon, has taken full advantage of the room for manoeuvre offered him by the present community set-up. Two clearly distinct phases may be discerned in his industrial policy:

1) an emergency policy, dictated by the need to deal with serious crises in sectors such as iron and steel;
2) a "prevention" policy designed to tackle future production and employment crises, such as the a

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greement for controlling imports of textile fibres from developing countries and the stimulus to community car manufacturers to put forward proposals for the rationalization of the sector in Europe.

Davignon's efforts, however, lack those aspects which are peculiar to an industrial policy proper: financial capacity and the power to implement active growth policies in fields that might lead Europe towards a new period of prosperity:

1) surmounting of internal imbalances by giving preference to investment in social services rather than to private consumption;
2) the development of the Third World countries;
3) new relationships of cooperation with the countries of the Eastern bloc based on intensified intrasectorial and multinational trade.

Such growth models can be pursued, however, only if a common European effort is made to equip the Community with the political and financial tools it needs to play a leading rôle in the recycling of oil surpluses and to effect an internal redistribution of resources to overcome its own imbalances.

The proposals of President Jenkins to relaunch the economic and monetary union, and the indications of the McDougall report regarding the expenditure necessary to give a federal tone to Community budget policy, are moving along these lines.

The achievement of such an important breakthrough in European economic policy can, however, only be guaranteed

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by a European executive and a European currency. Only by shaking off the supremacy of the dollar will it be possible to direct real money flows in such a way as to favour European growth objectives rather than allowing them to be determined by a world distribution of pur chasing power (and credit) dictated by America.
From the technical point of view, insurmountable diffi culties do not exist. From the political point of view, there is no justification for paralysing pessimism since the historical force of the moment emphasize the relative autonomy of politics.
The European elections decided on by the Copenhagen summit meeting may open up the way to the necessary constituent phase.

APPENDIX 1

PERFORMANCE OF TRADE BALANCES IN QUANTITY OF PRODUCING COUNTRIES

ITALY		G.F.R.		U.K.		FRANCE		BELGIUM		NETHERLANDS		EEC		U.S.A.		JAPAN	
1970	1976	1970	1976	1970	1976	1970	1976	1970	1976	1970	1976	1970	1976	1970	1976	1970	1976
+ 193.7 (1)	+ 243.0	+1336.9	+1167.7	+ 530.9	- 15.9	+1145.8	+1036.9	- 158.5 (3)	- 172.5	- 306.2	- 455.3	+2531.1	+1556.5	-1727.4 (4)	-1762.8	+ 707.8	+ 2500
- 50.3 (2)	- 16.7	+ 78.4	+ 309.3	+ 65.5	-233.8	+ 521.1	+ 598.2	- 138.1	- 104.6	..	- 360.6						

1) For Common Market countries only, the line refers to the overall balance, both intra and extra-Community.

2) For Common Market countries only, the line refers to the balance among member countries.

3) An attempt has been made not to consider vehicle sales in the form of CKDs.

4) The U.S. balance is usually published net of trading with Canada. However, it is considered preferable to show the overall balance.

APPENDIX 2

PERCENTAGE OF CONCENTRATION OF MOTOR VEHICLE PRODUCTION

	ITALY	FRANCE	U.K.	G.F.R.	EEC	U.S.A.	JAPAN	WORLD
1 Group	85.5	42.6	51.6	40.5	14.4	57.3	35.8	22.5
2 Groups	99.2	83.5	80.3	67.1	27.5	81.3	67.9	35.5
3 Groups	-	99.7	91.2	81.2	40.5	96.9	76.7	43.4
5 Groups	-	-	-	-	64.9	-	94.2	56.3
10 Groups	-	-	-	-	95.9	-	-	79.4

The Structural Weaknesses of the British Economy: and Policies to Reverse the Adverse Trends.

by Walter Eltis

The adverse trends from which Britain has been suffering are outlined in Table 1. This shows that if the employment trends of 1966-1974 continue until 1990 there will be over 3 million unemployed in Britain and an immense financial deficit. The table shows that from 1966 to 1974, the 8 years prior to the start of the world recession, Britain lost 1,144,000 jobs in the market sector, industry, agriculture, commerce, etc. The market sector produces all the output in the economy which is sold. It is therefore responsible for the production of everything that is consumed privately, the economy's entire exports and all capital investment. The market sector is financed from the proceeds of the goods and services which it sells. The table shows that the market sector jobs lost between 1966 and 1974 disappeared entirely in industry which lost 1,335,000 jobs in this period. The de-industrialisation trend which this indicates has worried almost all observers of the British economy, especially as industry lost a further 640,000 jobs in 1974-6 - the first two years of the world recession. It will be noted that the private services on balance also lost jobs between 1961 and 1974-76, so it is improbable that the British market sector as a whole can achieve a stable employment trend unless the process of de-industrialisation is halted.

Table 1 also shows that there has been a rapid increase in employment in the non-market government sector of the economy which exports and sells nothing. From 1966 to 1974 employment in this sector rose by almost a million. Employment in the public services has to be financed either by taxation or through budget deficits. If employment in the tax-paying sector of the economy declines, as it has in Britain, while employment in the government tax-dependent sector grows, rates of tax have to keep rising and if governments are unwilling to increase taxation as much as increasing expenditure calls for, government spending has to be financed increasingly through budget deficits. Where governments cannot borrow enough to finance these, they are driven to the printing press. Table 2 outlines the growth

in the British government's borrowing requirement in the period 1964-
This rose sharply in 1972-5 which was largely a consequence of the decline of the tax paying sector of the economy, and the growth of the tax-dependent government sector. Britain's money supply has been difficult to control in consequence since about 1972.

With the decline of employment in industry and commerce in Britain and the rise in government employment and in unemployment there has been a sharp fall in the number of market sector workers available to finance each worker in the public services and each unemployed worker. In 1961 there were 5.5 market sector workers to finance each worker who produced nothing marketable. In 1966 there were 4.8, in 1974 there were 3.6 and in 1976 there were 2.9. If recent trends continue there will only be 1.8 market sector workers to finance each public service worker and each unemployed worker by 1990. Taxation on the market sector to finance the non-market workers would therefore have to treble between 1961 and 1990 if recent trends continue. It obviously could not do so, with the result that governments would have to borrow and print money at an increasing rate if the trends outlined continue . It is clear that both the present Labour Government and the Conservative Opposition are aware of the problem and they can be expected to make every effort to reverse these trends.

There are a number of possible explanations of how the adverse situation has come about. One of the most important is based on the proposition that the goods which Britain produces have failed to hold their domestic and international market shares against international competition. Table 3 shows that from 1964-1974 Britain's share of world exports of manufactures fell from 14.4% to 8.8%. In the same period imports of manufactured goods increased from 6.7% to 15.6% of total domestic expenditure in Britain. The argument is therefore that weaknesses in industrial design and by management and labour (losing markets because of the delays due to industrial disruption) has led to declining market shares for British manufacturers and to a consequent fall in manufacturing employment. Given these weaknesses governments could not have produced a viable economy even if public expenditure had been held constant. That would have simply led to earlier mass unemployment, given the private sectors inability to compete in world markets and to defend itself against imports.

The alternative view is that it has been the growth of the government sector that has squeezed the market sector and left it too weak to compete successfully against foreigners. Table 4 shows the starting point for the presentation of this argument. Table 4 shows that from 1964 to 1974 net marketed output increased 14.7%, that is by about $1\frac{1}{2}$% a year. The national product increased faster - by 19.9% in 10 years - but marketed output increased less than this because much of the growth was in unmarketed public services. The government's purchases of marketed output rose 40.7% in this period in which output rose just 14.7%. As a result there was in ten years just 2% growth in the resources that remained for the market sector itself. In 1970 prices, the market sector had £24,457 million available to it in 1964 and £24,964 million available in 1974. Thus, between 1964 and 1974, the market sector of the U.K. economy was playing a near zero-sum game. It is impossible for all the participants in a zero-sum game to win, so those who play are in inevitable conflict vis-a-vis each other.

In the U.K. zero-sum game, we now know that workers won and companies lost. The share of wages in the national income increased approximately 6%. The share of profits, net of capital consumption and stock appreciation, fell dramatically. The profits trend is illustrated in Table 5. There was therefore a victory for workers against companies. Similarly, consumption won against capital investment and the balance of payments. Consumption in the market sector increased 12.5%; at the same time, the market sector goods and services available for net investment and the balance-of-payments fell 64.7%. Within this total investment in industry fell 18% while investment in building and the private services increased. The reason for the sharp fall in investment in industry in relation to investment in the rest of the economy was that the profit squeeze resulting from the zero-sum game was much sharper in industry than in the private services. In real estate, there was virtually no profit squeeze at all. The relatively greater profits squeeze in industry is illustrated in Table 5. This shows that profits were about 1% higher in manufacturing than for companies as a whole in 1964, but they were 2% lower in 1970, 1971 and 1972, 4% lower in 1973 and 9% lower in 1974.

We may now examine the form that the zero-sum game took in Britain and how workers succeeded in raising their share of wages at the expense of profits and, therefore, how they increased their private consumption at the expense of investment and the balance of payments. The workers accomplished this by exploiting every possible situation for competitive gain. To see just how this occurred it is useful to compare the United Kingdom and West Germany. In West Germany, public expenditure increased much faster than in Britain, but, because of the economy's successful growth achievements, private consumption also grew at a real rate of over 3% per worker per annum. So, during the German "economic miracle", workers were able to double their private consumption, roughly speaking, every 20 years. Thus, German workers and companies were playing a positive-sum game in which cooperation was rational. Workers were aware that if the German economic miracle continued they could double their private consumption every 20 years. To keep the miracle going, they had to make sure that companies would honour their sales contracts, that plants were used to normal capacity and that the benefits of modernization were not wasted. This attitude made possible rational cooperation between the trade unions and the employers - and cooperation is often the rational policy in positive-sum games.

Suppose, however, that in the German case trade unionists of the aggressive British type had put themselves forward for election to union office and said to the German workers - "You are failing to get the wages you are capable of getting. You could get more if you put pressure on your companies". The German workers could quite rationally reply - "By cooperating we gain 100% every 20 years. What can you give us if we fail to cooperate ? Maybe 10% or even 20%, after which the growth rate becomes slower, our plant ceases to be used properly, and our living standards cease to rise as they have been rising". The German workers would be perfectly correct and have been perfectly correct to reject that style of trade-union leadership. The workers have not rejected it because they were unwilling to support extreme left-wing politics - the history of Germany shows considerable support in the past for extreme left-wing politics. Rather, the workers have not accepted extreme left-wing trade-union behaviour because it has been irrational in post World War II Germany.

In Britain, with its much slower rate of economic growth, suppose that rational, cooperative, West German trade-union behaviour had been proposed to the workers - "Cooperate with the companies and you will enjoy stable consumption. Your living standards will go up at a rate of zero percent". This argument would stand no chance of success against the counter argument from the militants - "We can do better than stability". In the miners' union, the workers could be told - "The country cannot be run without electricity. We can prove it through a coal strike. If we prove it, we will get far larger wage increases than other people and therefore win in the zero-sum game". At the same time, the leaders of the dockers could say - "The employers have just introduced containerisation. This means that they need our cooperation because this expensive capital equipment, which will make many dockers redundant, needs to be worked if it is to be profitable. Let us therefore say to the employers that this equipment will be unworkable unless we get very large wage increases, larger than other people's, and large redundancy payments". The dockers exploited their peculiarly advantageous situation and received very large wage increases and substantial compensation for agreeing to cease to be dockers. The docks are now in many cases at the point of bankruptcy.

Many more actual cases from Britain could be enumerated. The vital point is that those who gained in the British industrial relations scene were those who had the strongest industrial muscle - those who put the most pressure on the employers and those who managed to obtain the largest wage increases earliest in each wage cycle. The unions that failed to elect militant and aggressive leaders to position of power lost in the struggle to be first in each wage round. Thus, there was a steady move toward militancy throughout the trade-union movement between about 1968 and 1974 as moderates were replaced with militants. This trend squeezed profits in the British economy in three ways.

The first was a result of the introduction of price and wage controls, which followed from the inflation that was produced by the militants*. The militants had the power, which they demonstrated, to raise wages and prices extremely rapidly; and, at various stages, price and wage controls were introduced in attempts to slow down the faster inflation which resulted. In return for wage restraint, the unions persuaded the government to introduce a series of controls which limited the profits that companies were allowed to earn. The result was that profits were squeezed significantly by both Labour and Conservative Governments in the period 1964-76.

Profits have not only been squeezed by price and wage controls, however; they were also squeezed in situations in which unions exercised local power, such as the case in the docks already described. In that situation, the profitability of introducing modern plant was greatly reduced because the plant was not worked effectively in its early years. In addition, the unions succeeded in reducing profits by altering the institutions of society in favour of wages and against the power of companies to earn maximum profits. In economics textbooks, companies equate the marginal cost of labour to its marginal revenue productivity. In other words, companies can choose how many workers they will employ. But, this has been less and less the case in Britain because legislation has been passed requiring companies to continue to employ workers when it is no longer profitable to do so or to make heavy redundancy payments. This and other legal changes in property rights diminished the profits that companies could earn from any given capital stock.

For these three reasons - price and wage controls and particularly controls over profits, union exploitation of local situations and legal changes in favour of wages and against profits - the fall in profitability in British industry was considerable. According to U.K. government figures, the real rate of return on capital net of all taxes fell from 10% in the middle 1960s to 2.2% in 1974. According to figures published by the Bank of England the

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* Monetarists do not allow that the unions have the power to cause rapid inflation, but it is possible to state the argument in terms that they would accept. Increased union militancy raises what monetarists call the "natural" rate of unemployment. In other words, the unemployment rate which is needed to prevent the acceleration of inflation becomes far higher than before. In consequence, a tough monetary policy would control inflation, but, given the greater militancy of the trade unions, it is only controllable at unemployment rates much higher than traditional levels. If governments try to maintain the standard lower unemployment rates, as they did in the U.K., then accelerating inflation results. Thus, governments are faced with a choice of either much higher unemployment than before - because the natural rate of unemployment has risen - or accelerating inflation. Price and wage controls are an attempt to escape this unattractive choice.

real return on capital fell by over one-half. The fall in profits is also illustrated in Table 5 and as has been remarked it was especially great in industry where union power was greatest. Obviously industrial profits were also squeezed by the declining competitiveness of British products against international competition which Table 3 indicates. The result was the great reduction in job creation in the U.K. industrial sector.

The large loss of industrial jobs followed, partly because of the fall in investment that resulted from the profits squeeze, and partly because the union pressures which have been outlined made labour extremely expensive to companies so that they had strong incentives to substitute capital for labour. Hence such investments as firms managed to make created fewer jobs than before because each new job cost far more in real terms, and the new jobs were therefore insufficient to make good all the jobs any economy must lose each year because of the obsolescence of plant, wear and tear and technical change and improved designs in the rest of the world. An American study has estimated that 43% of industrial jobs are lost each decade throughout the USA for these reasons, and that these have to be made good through the creation of new jobs which will often involve new designs and new technologies.(1) The position in Britain is almost certainly comparable, and there was simply too little investment to create enough new jobs to make good those that were lost. Hence the industrial part of the market sector employed fewer and fewer people.

The British Labour Government started to attempt to reverse the de-industrialisation trend in the spring of 1976. To assist it has come Britain's formidable new asset North Sea oil. Thus Table 6 shows that this can be expected to assist the balance of payments by about 25% of current import levels by the middle 1980s and it started to produce a considerable improvement to the balance of payments from 1977 onwards. This will allow the British Government to give more financial assistance to industry without the need to raise taxation on the rest of the community. It will also permit faster expansion of the economy without such deterioration in the balance of payments as there was prior to North Sea oil. The Government has also taken steps to increase the profitability of British industry. Companies were

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(1) G. Breckenfeld, "Business Loves the Sun Belt (and Vice Versa)". Fortune, June 1977, pp. 132-46.

treated much more favourably through, in effect, lower company taxation, after 1975. There was also a reduction in taxation for smaller companies in the Budget of 1978. The Government's help mainly took the form of allowing companies not to pay tax on profits that were merely the counterpart to inflation: there has been no reduction in official rates of company taxation. The Government has also increased the profitability of exporting through a substantial devaluation of the currency which, as a result of successful incomes policies, has not been matched by an equivalent wage inflation. At the present time British wage costs are perhaps 8-10% lower in relation to foreign wage costs than they were in March 1976. Possibly as a result of the maintenance of a competitive pound, Britain's share of exports in world markets which fell so sharply in 1961 to 1974, fell no further between 1974 and 1977. During this 3 year period Britain's share of exports in fact rose a little and British companies managed to increase their exports as rapidly as world exports which is a hopeful development. Britain's trade weaknesses ought not to be exaggerated. The share of imports has risen sharply in Britain but this has been equally true of other economies. A study prepared in the Federal Reserve Bank of New York has estimated that in 1970-1976 each 1% rise in Britain's G.D.P. raised imports 2.12% but West Germany's imports rose 2.04% for each 1% rise in G.D.P., United States imports 2.55%, Italy's 1.91%, and France's 1.90%; i.e. the tendency for imports to rise faster than the national product has been universal. Only Japan with its one-way trade restrictions has escaped this trend. It is Britain's export weaknesses that especially merit attention because other countries have not shared Britain's decline in world markets and the de-industrialisation of Britain has certainly been associated with a weak export performance. It is most encouraging therefore that Britain is now holding its share of world export markets.

Since 1976 the British government has arrested the growth of its own spending, and real Government spending fell about 5% between 1976 and 1978 which has permitted considerable reductions in taxation and also reductions in the government's financial deficit from 8.7% of the National Product in 1976 to about 4.5% in 1977-8. The market sector of the British economy is therefore now playing a positive-sum game in place of the previous zero-sum game with the result that there should be a return to cooperation between management and labour in industry if the previous analysis is correct. A number of British trade unions and especially the A.E.W.U., the second largest, have been electing moderates to positions of power and this should lead to more cooperative industrial relations in the 1980s.

There has not yet been a revival of output growth in Britain because the various policies which have been described have been accompanied by an unprecedented rise in the private savings ratio to 18%. It is widely expected that this rise in the savings ratio will be reversed later this year with the result that demand and output will then start to expand in line with exports.

Looking ahead, recovery will depend on the ability of industry to produce internationally competitive products. The improvement in company cash flows which have resulted from the Government's tax changes and the reduction in wage costs (measured in foreign currency) will make it possible for industry to spend more on research and development and marketing, which will help to guarantee British market shares in the 1980s. The presence of North Sea oil should help to guarantee a much better overall balance of payments performance. A recovery of profitability will help to attract foreign capital and foreign designs and know-how to Britain. The question is whether this will be enough in view of the extremely unfavourable trends, shown in Tables 1 and 3, which need to be reversed.

Table 1

BRITISH EMPLOYMENT IF THE TRENDS OF 1966-74 CONTINUE UNTIL 1990

	1961	1966	1974	1976	1982	1990
Total Labour Force	25,394,000	25,711,000	25,691,000	25,987,000	26,817,000	27,737,000
Self-Financing Market-Sector Employment in Industry, Commerce, etc.,	21,499,000	21,273,000	20,129,000	19,350,000	18,985,000	17,841,000
of which						
Employment in Industry	11,065,000	11,230,000	9,895,000	9,255,000		
Employment in Private Services	8,080,000	7,887,000	7,891,000	7,814,000		
Employment in Agriculture,etc.,	604,000	475,000	417,000	395,000		
Self Employment	1,750,000	1,681,000	1,925,000	1,886,000		
Tax and Deficit-Dependent Government Employment in Public Services, etc.	3,558,000	4,078,000	4,931,000	5,363,000	5,784,000	6,637,000
Unemployment	337,000	360,000	631,000	1,274,000	2,048,000	3,259,000
Number of Market-Sector Workers Available to Finance each Non-Market Worker	5.52	4.79	3.62	2.92	2.42	1.82

The statistical basis of this table is set out in Robert Bacon and Walter Eltis, Britain's Economic Problem: Too Few Producers, 2nd Edition, Macmillan, London, 1978, pp.119-20. The additional data on employment in industry, etc., is derived from the relevant series in the CSO's Annual Abstract of Statistics.

Table 2

THE GENERAL GOVERNMENT BORROWING REQUIREMENT AS A RATIO OF THE GROSS DOMESTIC PRODUCT

	GDP	Borrowing Requirement	Ratio
1963	£25,836 m	£842m	3.26%
1964	£29,182 m	£989 m	3.39%
1965	£31,212 m	£1,205m	3.86%
1966	£33,083 m	£961m	2.90%
1967	£34,877 m	£1,863 m	5.34%
1968	£37,390 m	£1,278 m	3.42%
1969	£39,338 m	- £466m	- 1.18%
1970	£43,368 m	- £17 m	- 0.04%
1971	£49,151 m	£1,372 m	2.79%
1972	£54,958 m	£2,047 m	3.72%
1973	£63,492 m	£4,168 m	6.56%
1974	£73,652 m	£6,336 m	8.60%
1975	£93,078 m	£10,512 m	11.29%
1976	£109,080 m	£9,512 m	8.72%
1977	£122,453 m	£5,701 m	4.66%

Source: Economic Trends

Table 3

BRITISH INDUSTRY'S DECLINING SUCCESS AGAINST INTERNATIONAL COMPETITION

	Share of UK Exports of Manufactures in World Markets	Ratio of UK Imports of Manufactures to Gross Domestic Expenditure in the UK
1964	14.4%	6.7%
1965	13.9%	6.5%
1966	13.4%	7.1%
1967	12.3%	7.8%
1968	11.6%	9.6%
1969	11.3%	9.9%
1970	10.8%	10.1%
1971	10.9%	9.6%
1972	10.0%	10.6%
1973	9.4%	13.4%
1974	8.8%	15.6%
1975	9.3%	13.1%
1976	8.7%	14.5%

Source: National Institute Economic Review, Economic Trends and and the CSO's United Kingdom Balance of Payments.

TABLE 4

THE SQUEEZE ON THE BRITISH MARKET SECTOR IN 1964-74

(all figures are in constant 1970 prices)

	1964	1974	Increase
Net National Product	£40,463m	£48,497m	19.9%
Net Marketed Output	£36,324m	£41,659m	14.7%
Purchased by the Non-Market Sector	£11,867m	£16,695m	40.7%
Remains for Market-Sector	£24,457m	£24,964m	2.1%
of which			
Consumed by Market-Sector	£21,163m	£23,802m	12.5%
Available for Investment and Balance-of-Payments	£3,294m	£1,162m	- 64.7%
Producing the Result			
Net Industrial Investment	£1,463m	£1,196m	- £267m (18.3%)
Net Non-Industrial Investment	£2,593m	£2,814m	+ £221m (8.5%)
Exports less Imports	- £763m	-£2,847m	- £2,084m
	£3,293m	£1,163m	

The statistical basis of this Table is set out in Robert Bacon and Walter Eltis (op. cit.), pp.243-7.

Table 5

UNITED KINGDOM COMPANY PROFITS AS A RATIO OF VALUE-ADDED

	All Companies	Manufacturing Companies
1961	15.2%	14.9%
1962	13.1%	13.1%
1963	15.6%	15.5%
1964	17.1%	17.9%
1965	16.7%	16.8%
1966	14.4%	14.0%
1967	14.4%	13.7%
1968	15.1%	13.3%
1969	13.2%	12.5%
1970	10.4%	8.0%
1971	12.6%	10.1%
1972	13.0%	10.8%
1973	12.0%	7.2%
1974	3.7%	- 6.0%

This series shows company profits net of capital consumption, stock appreciation and taxation. The derivation of the data is set out in Robert Bacon and Walter Eltis, op.cit., pp.231-8.

Table 6

EXPECTED NORTH SEA OIL OUTPUT

	Expected Oil Output measured in 1975 prices and excluding indirect taxes	Ratio of Expected Oil Output to 1975 Imports in 1975 prices
1975	£66m	0.25%
1976	£506m	1.94%
1977	£1,596m	6.12%
1978	£2,520m	9.66%
1979	£3,696m	14.17%
1980	£4,368m	16.75%
1981	£5,082m	19.48%
1982	£5,502m	21.10%
1983	£5,838m	22.38%
1984	£6,132m	23.51%
1985	£6,090m	23.35%

Source: National Institute Economic Review, March 1978.