

government and industry : a new partnership

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1. introduction

In a period of rising and disastrous unemployment, such as we are faced with in this country today, it is very easy to fall back on simple and dramatic solutions. Unfortunately the industrial problems we are currently confronting are too complex and deep seated to be amenable to such solutions. We need instead in the Labour Party today to face up to the problems created by structural change and the failure of industry to innovate and adapt. Only in this way will we be able to develop practical policies which will deal with the hardships of poverty and economic insecurity.

Any industrial policy, if it is to be more than a series of *ad hoc* initiatives, must be based on a real appreciation of how industry ought to be responding to current economic, technological and demographic changes, and on a clear understanding of the life cycle of industries. Otherwise, too much effort is likely to be spent on trying to rescue industries in structural decline, instead of cutting them back to defensible segments, and not enough time is likely to be spent on promoting new industries. The second chapter of this pamphlet, therefore, looks at some of the factors making for industrial change today.

If industrial policy is to produce results, it is also important that government intervenes in the most effective way possible, and the second chapter next looks at the three main areas where government can and ought to intervene, namely, the intellectual attainments and skills of the labour force, Research and Development (R and D) activities, and the process whereby funds are channelled to industry. These all involve complex policy issues, and the rest of the pamphlet concentrates on showing, by way of illustration, how government and industry should work together in partnership in the third of these areas, the process whereby funds are channelled to industry.

The third chapter looks at why our financial system is not good at stimulating structural change, and the fourth looks at two recent attempts to improve it the NEB and Planning Agreements.

The record of the NEB in a number of areas has been extremely good and should be built upon, while it is difficult to see Planning Agreements ever having more than a very limited use. Certainly they should not be seen as a general instrument to increase the efficiency of British industry.

As socialists we have a commitment to try to understand the economic forces at work in our society, and to shape them to increase the wealth of society and its fair distribution. But this should not mean, as it has done so often in the past, that we should seek to centralise power or reduce the number of decision making points. Such centralisation is always likely to be undesirable, but where investment is concerned, which inevitably involves a large element of judgment, it is likely to be disastrous. The fifth chapter, therefore, sets out a number of practical proposals for improving the flow of funds to industry which rely to the greatest extent possible on market forces, but which also depend on selective government intervention. An English Industrial Development Bank is proposed which would be concerned with the rediscounting of loans made by the banks, interest rate subsidies and the provision of equity finance to small businesses. A number of fiscal changes are also proposed which would help to correct the bias in our tax system which deflects savings into owner occupied housing, pension funds and life insurance, and away from industry.

It will, of course, be said by some people that a future Labour government should set itself more important objectives than helping industry to restructure itself. But the reality is quite the reverse, as the restructuring of industry should be at the top of the agenda of a future Labour government for a number of reasons. Firstly, in the long run there is no way that technological innovation or changes in the international division of labour can be held back. A future Labour government should try, therefore, to anticipate these changes and to restructure industry as necessary. Only in this way can unemployment be reduced, and the hardship which attends the collapse of the

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competitive position of whole industries be avoided. Secondly, if we are to achieve other objectives in the fields of urban renewal, the social services, education, or support for the arts, we will only be able to do so by first creating additional wealth. Finally, a policy of restructuring industry is the only possible way to mesh industrial policies to aid industry with a socialist commitment to the Third World and the abolition of poverty. The recovery of British industry does not lie in supporting worn out factories and structurally declining industries at the expense of the developing countries, but in seeking to export to new and growing markets in the Third World. If sensible industrial policies are adopted, the developing world can be seen as an opportunity and not a threat. For all these reasons then a priority of the next Labour government should be a set of industrial policies to help the restructuring of

2. the restructuring of industry

As economic, technological and demographic changes take place, so it is essential that industry adapts the products and services it offers, and the processes whereby it produces them, to these changes. It may be necessary, for example, for industry to install new capital equipment which takes account of the new costs of energy, or to enter into a new market made possible by technological innovation, or to run down a product range which it is no longer economic to produce in competition with the newly industrialising countries (NICs) because of their lower wage costs. Whatever the nature of the change, if industry does not restructure itself to meet the challenge, it will soon find its exports uncompetitive in world markets and its home base under attack from imports.

The speed of such change at the moment is very great. The oil crisis of 1973-74, and the increase in the price of energy, meant that much capital stock based on energy intensive technology was no longer economic. There is also the effect of new technology, which can have an impact on industry in two different ways. It can lead to the development of new industries, such as the manufacture of robots, small computers or facsimile equipment. But it can also radically alter traditional industries. The impact of quartz technology on the watch industry in Switzerland is a good example, and it is likely that the whole range of consumer products, including cookers, motor cars and television sets, will be made much more sophisticated by the use of electronic components.

A third factor making for industrial change, and the need for restructuring, is the rise of the NICs and a change in the traditional international division of labour. In the past, developed countries specialised in capital intensive industries while developing countries concentrated on labour intensive industries. But for a number of reasons this international division of labour is now breaking down. Capital can now move more easily between countries and developing countries can now more easily acquire the process automation necessary to enter certain

fields. As a result, developing countries have been entering such areas as ships, steels and fertilisers, and making a major impact because of their lower wages. The importance of this change can be seen very clearly in the case of the Swedish shipbuilding industry. Sweden is probably the most efficient builder of ships in the world but it is no longer competitive in world markets. Its productivity is twice as high as Korea and Spain but it has to contend with the fact that its wage rates are eight times as high as Korea and four times as high as Spain.

In most other industrialised countries, government and industry have appreciated the significance of these changes. The main objective of Japanese industrial policy, for example, has been the careful restructuring of industry over time towards higher value-added industries, what they call "knowledge intensive" industries. They have realised that the only way to deal with industries threatened by the NICs is to let them migrate to the low wage cost countries, or to find defensible segments in them, while moving resources made available by disinvestment into new industries where they are likely to have a comparative advantage.

Thus they have, since World War II, gradually moved from cheap cameras, textiles and fertilisers to such products as precision optics, computers and medical electronics. Nor have the Japanese allowed themselves to be deflected from this strategy even in difficult times. The 1970s have seen, for instance, the emergence of the four "New Japans", South Korea, Taiwan, Hong Kong and Singapore. These four countries have produced industries which appear able to compete with Japanese industries in third markets, and even to some extent in Japan's own domestic market, in such areas as petrochemicals, steel, fertilisers, textiles and ships. By and large Japan has done very little to protect its domestic industries. For example, in the case of textiles, they have phased out their cheaper products and Japan is now in fact a net importer of textiles. They have not in all cases followed the logic of their economic strategy. The import of silk products from

Korea and China are controlled on a quota basis because the silk growers and processors are an important rural lobby in a country whose conservative government is dependent on rural votes, but by and large Japan has not given in to the pressures to protect declining industries and has sought rather to stimulate new ones.

non-price competitiveness

In West Germany, France and Sweden too there has been a clear appreciation by government and industry that restructuring is necessary. In this country, by contrast, the need for restructuring does not appear to have been fully grasped, either by government or industry. It is not simply that we have not invested enough in new industries, such as robots or office automation, but over a wide range of industries we have failed to invest in high quality, up to date products. For example, the unit value of a tonne of West German engineering products increased from being nearly the same value as a tonne of comparable British goods in 1963 to being 1.46 times the British figure in 1975 (Ray Rothwell, "Where Britain Lags Behind", *Management Today*, November 1978). This figure implies very strongly that there is a significant difference in the quality of the product mix of the two countries, with West Germany constantly upgrading the sophistication of its products. Also, a comparison of the relative value per tonne of engineering imports and exports of the UK and West Germany suggests that the UK exports cheaply and imports expensively in engineering products, while the opposite is the case in West Germany.

Some further evidence which confirms this view can be obtained from a survey in 1977 of 107 UK textile companies. They were asked if they had bought foreign built textile machinery between 1970 and 1976 and, if so, why. 27 per cent said that a machine to suit their requirements was not available in the UK, and 32 per cent said that the superior overall performance and design of foreign machines was the reason for the decision they had

made. Only 4 per cent said that they had bought foreign built machinery because it was cheaper. This failure to innovate means that in many industries such as typewriters and motor cycles we have dropped out of the industry altogether, while in others such as agricultural machinery we are finding it hard to survive.

how government can help

There are many people who would accept this analysis but who would nevertheless argue that there is nothing that the government can do to correct it. If industry won't innovate, then there is nothing that the government can do to make it. And yet there are many dimensions of the problem of restructuring on which the government can act.

There is first of all the whole question of the intellectual attainments and skills of the labour force. It is clear that inadequacies of skilled manpower have been a major weakness on the supply side of the British economy, and one which by its nature affects decision making at all levels of industry. It is also important to realise that it is a problem which if it is not solved will place a crippling burden on industry in the future. We should not seek to compete with the NICs in labour intensive industries, where their lower wages are bound to give them an advantage, but rather in "knowledge intensive" industries, which by definition will depend on highly trained engineers.

It is interesting again to compare our situation with that of Japan, as the Japanese regard engineers as their most precious industrial asset, and engineers play an enormous role in industry. A survey of major Japanese manufacturing industries showed engineers holding 67 per cent of the Board seats, and in some of the high technology areas, for example electronics and chemicals, the Board members were all engineers. Equally, in the Ministry of Science and Technology, as many as one third of the top officials are engineers, and in the Agency for Industrial Science and Technology only

one of the top officials has not been trained as an engineer. In fact, a major priority of the Japanese is the development of educational systems which produce able engineers and research workers. In most other countries it is clearly understood that this is an area where the government has a responsibility to act and the power to do so, and in the future the government in this country must face up to this responsibility.

The education system needs also to be complemented by a substantial and intensive training effort. The CBI survey of industrial trends which covered the first half of July 1979 showed 21 per cent of companies saying that their output was limited over the next four months by a lack of skilled labour, which is an extraordinary problem at a time of high unemployment. It has also, for example, been argued that the various government schemes to subsidise experimental and advanced machine tools have not been very successful because they have essentially been attempts to deal with symptoms, rather than the root cause which is the lack of highly skilled manpower. By comparison with Germany, which has over a third of the world trade in machine tools, the extent and nature of the technical training of the British labour force is clearly deficient.

Here again the government can and must act. Not only through the Industry Training Boards and the Manpower Services Commission but also through, for example, its policies on housing, which can have a critical impact on mobility. It is important to realise that there is no such thing as a single labour market within the country which can easily be manipulated by fiscal and monetary means. Rather there is a whole variety of sub-markets for labour. And here we still have a lot to learn from the approach of the Swedes. As Santosh Mukherjee has written: "They have recognised and taken as a basis for their policies a more realistic view of the behaviour of labour markets. Swedish authorities do not believe that general measures are enough in themselves. That approach is inadequate whether from the point of view of

containing inflation, or as a device for shifting manpower and other resources out of the less productive sectors into the more efficient ones. For those allocative changes to be produced by the labour market, market supportive measures are needed. And that, in the Swedish view, requires direct action from powerful institutions with large resources of finance and skilled personnel at their disposal" (*Making Labour Markets Work—a comparison of the UK and Swedish systems*, PEP Broadsheet 532).

research and development

A second dimension of industrial restructuring which is important, and where the government can act, is R and D activities. Technical innovation is clearly an important factor in explaining different levels of performance in international trade in capital goods, and the government can seek to stimulate such technical innovation by providing funds. In the past, however, the funds supplied by government in this country have been allocated very badly, with the result that the role of government in this area of restructuring has been discredited. But rather than assuming that government has no role in this field, we should seek to analyse what went wrong in the past, so that in the future funds can be allocated better. This is an essential step forward, as it is difficult to see how British industry will be able to compete in world markets in the future without such funds.

While today the scale of German and Japanese industrial R and D is much greater than ours in absolute terms, in the 1950s and 1960s we devoted greater resources to it. However, this greater effort was not reflected in a better performance. The main reason for this failure, as Sir Ieuan Maddock pointed out in 1975 when he was Chief Scientist at the Department of Industry, is that the distribution of government research to different industries has been very eccentric. It has not correlated in any way with the size and significance of the sectors involved. Two fairly small industries, aerospace and electronics, have received

most of the funds, while other very large ones such as mechanical engineering have received very little. Thus this innovative effort had very little pay-off for two reasons. In the first place, it could not have a major impact because of the size of these two industries. Secondly, these two areas were the ones where the US was also putting her major effort. Thus the companies who benefited from these funds had to compete against the giants of American industry, in areas where enormous economies of scale operate.

It is interesting again to compare our efforts with those of another country, in this case Germany. In the 1950s and 1960s money was put into large scientific programmes in nuclear, aerospace and computer technology, the idea being, as in the UK, to catch up with the United States. However, in the late 1960s the need for industrial restructuring to higher value added businesses was realised, and an increasing level of government support began to be channelled to industry through the *Bundesminister für Forschung und Technologie* (BMFT), the Federal Ministry for Science and Technology. Since 1969, the proportion of the total amount spent by industry on R and D which comes from the federal government has increased from 14 to 20 per cent and there has also been a major change in the areas to which the funds are allocated. In 1969 electronics and engineering businesses only received 8 per cent of the total federal funds, while in 1977 they received 31 per cent. The method whereby projects are funded is also important. BMFT officials work very closely alongside industry, and take into account the competitive dynamics of the businesses which they wish to aid. Typically projects are funded 50 per cent by the BMFT and 50 per cent by the company, so that the companies have a strong incentive to make a success of the projects.

funds for industry

A third dimension of industrial restructuring is the process whereby funds are channelled to industry. And here again

the government has a critical role to play. Clearly the process whereby funds are channelled to industry is important in any strategy to restructure industry, as there is a clear connection between investment and the up-to-dateness, technical specification and design of products, in other words their non-price competitiveness. To improve our non-price competitiveness will, therefore, require a rapid rate of gross investment, given that capital equipment is to a great extent specific, not only in respect of the techniques of production, but also to the range of products it can produce.

In trying to establish whether a system for channelling funds to industry is effective or not, there are two criteria which should be used. Firstly, does it direct the available funds to the right companies and industries? A lack of investment in the past and the need for restructuring are not the only things wrong with companies in this country. In many cases productivity is simply too low due to management incompetence and the inflexibility of labour practices. It is essential that funds do not go to these companies, but rather to ones that have a good record of productivity. The financial institutions would like to believe that the low productivity of British industry is something outside their control, but by seeking out and rapidly expanding small and efficient firms, rather than doling out indiscriminately funds to established ones with a poor record, they can play a significant part in increasing the overall productivity of British industry. The second aspect which needs to be considered is whether the supply of funds and the cost of capital are at levels which are desirable from an economic policy viewpoint. Both these aspects of the system are ones that the government can influence, and indeed must seek to influence, if the system is not working well.

the environment for investment

In this connection, it is also important to understand, as the Boston Consulting Group pointed out in its study of Swedish industrial policy that the environ-

ment within which industry has now to operate has changed in a number of ways which make it less likely that the necessary level of investment will take place spontaneously. In the first place the necessary investments which industry has to make are larger and riskier. The reasons why the scale of investments is larger include an increase in the optimum manufacturing scale, an increase in the level and speed of the necessary R and D and a rapid growth in system sales. The growth of system sales, or entire plant sales, is due in turn to two factors. The first is the increasing use of computer intelligence in the process control of factories, which means that components and machines have to be designed with a knowledge of the whole factory within which they will be used, and the second is the growth of developing countries and Eastern bloc countries as purchasers of engineering equipment. Because of their lack of technical skills it suits these countries to buy entire plants rather than buying the parts separately and putting them together themselves (*A Framework For Swedish Industrial Policy*).

At the same time as the level and risk of investments has been increasing, so another set of changes has taken place which has made it less likely that companies will be able to achieve traditional levels of profitability. Governments in a number of countries have been prepared to subsidise investments for reasons of national policy, and this clearly makes it more difficult for companies in other countries to achieve high levels of profitability. Then again companies, particularly in Japan, have been prepared, on strategic grounds, to accept low levels of return while they built up market share. Finally, if the financial system of a country allows a company to maintain a high debt-to-equity ratio, then that company will be able to accept a lower return on its capital and still give a reasonable return to its shareholders than a company in a country where the financial system does not enable it to do so. It is interesting to note that, during the years 1966-1972 when the Japanese steel industry was gradually drawing ahead of the steel industry in the USA, it had a

lower average return on assets (1.8 per cent for the Japanese top five companies and 3.8 per cent for the USA top eight companies) while its marginal debt-to-equity ratio was over 11 to 1, thus giving a satisfactory return on equity to its shareholders.

A third point about the environment made by the Boston Consulting Group in their study is the changing nature of the capital investment which needs to be made in the "knowledge intensive" businesses that are growing up. In these industries, investments in areas such as R and D, applications engineering, marketing and distribution, and labour training may often be more important than investments in plant. And yet it may be more difficult for them to raise money for such "expense investments" than for investments in plant.

It is clear then that in a number of important ways the government can aid the restructuring of industry. But it must do so in partnership with industry. Government can provide industry with leadership and a framework of support, but it must then leave industry to make its own decisions. It is idle to think that government can withdraw all support from industry, but it is also idle to think that government can take on behalf of industry the millions of decisions that need to be taken on prices, product design, production methods or industrial relations.

In order to show more precisely how such a partnership should work, the rest of this pamphlet will look in more detail at the process whereby funds are channelled into industry. This should not be taken as implying that the financing of industry has been the major cause of the failure of our industries to grow in the past, or that improving it will lead on its own to a faster rate of growth. There must be progress on a large number of fronts simultaneously if British industry is going to be able to compete in world markets again. But it is an area which illustrates very clearly how industry and government need to work together, and an effective system of channelling funds to industry must be central to any set of policies aimed at restructuring industry.

3. the financial institutions and industry

Industry in this country needs to be restructured, and if this restructuring is to take place it is necessary for substantial funds to be put at the disposal of industry. It is essential, therefore, to make certain that the systems we have in Britain for channelling funds to industry are both effective and efficient.

However, for a number of reasons, some of which have a long history and some of which have a recent origin, our financial system is not well geared to serving the needs of industry if we judge it against the two criteria we have selected for evaluating such a system.

Firstly, how good is the system at directing the available funds to the right companies and industries? The answer is that it is not very good because it is based on the view that the management of money and the management of industry are two quite separate functions which are best kept apart. The fact that Britain was the first country to industrialise meant that there was no need to set up a system to channel funds on a continuous and large scale to industry. Businesses were able to start out small and to grow by means of retained earnings. The role of the banker in this system was simply to receive cash surplus to the immediate needs of the owner on short term deposit, which he then lent, also on a short term basis, to industry to cover shortages of cash. Today, there is a longer term element in this unique British concept of the overdraft facility, but even so most British bank managers like to see fluctuations from debit to credit in the balances of the accounts of companies with which they deal.

foreign examples

In Germany and France, however, a conscious effort had to be made to catch up and this in turn led to the setting up of the necessary institutions. In Germany this process started with the setting up of new banks in the 1850s with the clear aim of aiding industrial development. Y S Hu has described the role they had to play in contrast to the situation in

Britain: "To promote industrial development, the banks often had to help, or take the lead, in the setting up of joint-stock industrial companies. In England, the industrial enterprises had been established and financed by private individuals largely out of their own large fortunes and those of friends and relatives in the local region; this was possible because there were large pockets of individual wealth amassed from trade, shipping and the colonies. In Germany there was no such class of people, hence Adolf Weber's saying that German banks had been founded for people who needed money and British banks for people who had money. Moreover, because England was the first nation to industrialise, her enterprise could afford to wait to grow from small beginnings and on the basis of retained earnings. When Germany began to industrialise, she had to face Britain's supremacy, and technological progress meant that the average size of plant had become much larger. Hence large amounts of capital were needed to establish industrial enterprises, which only organised finance could provide" (*National Attitudes and the Financing of Industry*, PEP Broadsheet No. 559).

In the German system the role of the banker was to collect the savings of the vast mass of people and invest them on a medium or long term basis in industry. The bankers also saw themselves as being responsible to the government through the national bank for making certain that these savings were used in support of national policy, and in order to achieve this objective they developed the system whereby one of them would be responsible for monitoring the performance of a company and the others would give it proxy rights. Thus the German banks after the war played a considerable role in the rebuilding of German industry and today Germany has a financial system closely integrated with industry, and an efficient system for channelling savings into industry.

In France it was the period after World War II which saw the creation of a system for directing the flow of funds into industry. The key mechanism here

was the "mobilisable" medium term credit. This was a means of getting the banks to lend on a medium term basis, in spite of the fact that the bulk of their deposits were short term, by giving them refinancing facilities, and it brought together the commercial banks with the public or semi-public financial institutions such as the *Crédit National* and the *Banque de France* in an integrated financial system. The commercial banks were enabled to rediscount their medium term loans or sell them with a commitment to buy them back at a later date, and in this way protect their liquidity. They still, however, carried the credit risk. Before a loan could qualify as "mobilisable" the relevant institution working in close cooperation with the *Commissariat du Plan*, the *Banque de France* and other institutions, had to give approval, and this obviously gave a means to the authorities of directing funds where they were wanted.

An important use to which this mechanism has been put has been to protect industry's investment plans during credit squeezes. In periods when monetary policies have been used to control inflation medium term loans rediscountable at the *Crédit National* have always been rediscountable *hors plafond*—that is above the maximum rediscount ceiling allowed each bank by the authorities.

support from the banks

The result of these arrangements in Germany and France for channelling funds to industry (which are to some extent paralleled in Japan) is that the banks provide a much greater degree of support to industry than in Britain. To quote Y S Hu again: "It appears that, when industrial firms in other countries confront international competition, they have behind them the support of their banks, special-status credit institutions or even governments. British companies are perhaps not so fortunate: alone and single handed they have to face up to 'Germany Incorporated', 'Japan Incorporated' or 'France Incorporated', in a contest in which the dice may be loaded . . . the

struggle may be likened to a battle between two armies, logistic support being for one of them a matter of course, but being denied the other unless it first wins the battle and can use the booty to justify the supplies" (*ibid*).

flaws in the system

But in practical terms what are the consequences of this different tradition of banking? In what circumstances does it affect the decisions that the managers of industry make, and does it have any real impact on the economic performance of a country? It needs to be said first of all that a medium sized company in Britain in an established industry with a strong balance sheet and a good five year record of growing profits will not have any difficulty in raising funds. But this tells us very little. The performance of the financial system of a country must be judged by how it does in more difficult circumstances. Is it, for example, good at providing funds for new and rapidly expanding businesses? How good is it in supporting businesses that have to depress their profits short-term in order to achieve long-term viability? How efficient is it in dealing with companies that get into difficulties? And, finally, how good is it in times of credit squeezes in providing funds to companies with long-term viability, while withdrawing support from companies which don't have a long-term future? If the financial system in this country is judged by how well it performs in these sort of circumstances, then the reasons why the German, French and Japanese systems are better at providing support for industry can clearly be seen.

The position of new businesses and rapidly expanding ones, when it comes to raising funds, are much the same, if we define the rapidly expanding business as one that cannot find from its retained earnings the money it needs for investment to meet demand. In Britain such businesses will be able to take on much less debt than in other European countries or Japan. This is important because it can easily be shown that, with a given

rate of return on capital employed which is greater than the rate of interest, a higher ratio of debt to equity makes possible a higher rate of growth, both absolutely and proportionally. Why the new business or the rapidly expanding one in this country is able to take on much less debt follows inevitably from the lack of a tradition of industrial banking.

The American Banks Association of London, when it gave evidence to the Wilson Committee (*Evidence on the Financing of Industry and Trade*, Vol 8) made the point that there are two approaches a bank can take to lending decisions, the "liquidation" approach and the "going concern" approach. The "liquidation" approach starts with the assets and liabilities of the company looking for funds, adjusts for what would happen in the event of a liquidation, and then aims to have a safety margin. The "going concern" approach, on the other hand, makes the lending decision dependant on the ability of the company to generate funds to service the principal and interest on the loan. While they were careful in their oral evidence to say that they were not implying that the British banks only used the "liquidation" approach while they relied more on the "going concern" approach, there can be no doubt that this is the case. There is in fact no other way it could be given the lack of industrial expertise in the British banks. Anyone with a limited amount of financial expertise can evaluate the balance sheet of a company. If need be an outside valuation can be obtained of the value of the assets. But when it comes to evaluating the future cash flows of a business then industrial expertise becomes necessary. And, if one uses a "liquidation" approach, it follows that one is not going to allow a company to build up a lot of debt.

A further advantage of the approach adopted by the German, French and Japanese banks is that it almost certainly leads to better investment decisions. Because they employ people who can understand the industry, the market, the production technology and the management capability of individual companies, typi-

cally engineers and technically qualified people with experience of industry, they are able to weed out poor projects which in Britain would go through simply because the company has a strong balance sheet.

the City

The second area where the British financial system, and its lack of an industrial banking tradition, impacts unfavourably on the performance of companies is the much larger role played by the City, which has an almost total concern with the short-term performance of companies. Because the banks control and own very few shares, and because companies depend much less on loans, the stock market is much larger and more active in Britain than in Germany. Also because of the poor performance of equities in recent years compared with property and gilt-edged securities, and the lack of an industrial banking tradition, investing institutions and individuals have taken a very short-term view of company profits. They have traded actively to achieve capital gains rather than looking for long term investments, and companies cannot ignore this short-term approach. Companies have to worry about their share price if they are thinking about raising funds by issuing shares, and they will also want to keep it high so as to make it more difficult for another company to take them over, and easier for them to take over someone else.

The harmful effect that this concern with short-term profits has on industrialists, is that it encourages them to boost current earnings at the expense of product development and other costs which may be essential to their long-term profitability. Christopher Lorenz in his pamphlet *Investing In Success: How To Profit From Design and Innovation* (The Anglo-German Foundation for the Study of Industrial Society, 1979) contrasts the approval given to Siemens, West Germany's largest electronics manufacturer, when a few years ago it increased its profits but cut its dividend in order to provide for increased spending on capital

investment and product development, with the approval in 1978 when EMI slashed its R and D spending and maintained its dividend at the previous year's level. In this connection it is also worth remembering that Pilkingtons have argued that they could never have put the necessary money over a number of years into the development of their revolutionary float glass process if they had been a public company.

remedies for bad management

The third situation where the British financial system works less well than some of our competitors is where a company gets into difficulties. It follows from the view that the managers of money and managers of industry must be closely involved, that poor performance is seen to be as much the responsibility of the investor as the industrialist, and that consequently the investor should take action to see that the situation is put right. Thus if a German company gets into serious difficulties, the house bank steps in as *chef de file* of all the banks involved, and a member of its management board becomes the chairman or vice-chairman of the company. In fact, because of the much closer relationship between banks and industry in Germany, action is likely to be taken before this situation is reached. It follows, however, from the separatist view of the relationship between the managers of money and the managers of industry that where a company turns in a bad performance, that this should lead to the withdrawal of financial support so that the money can be invested elsewhere. The result is that in Britain the management of companies that get into difficulties is something that we are very bad at doing, there being virtually no remedies for bad management other than bankruptcy or takeover. The result is that many companies continue to run extremely badly without anything being done to put them right, until they reach the point where nothing can be done to make them viable again. As Sir Leslie Murphy said when he gave evidence to the Wilson Committee "There is no doubt in my mind that

existing arrangements do not work very satisfactorily for companies which begin to get into trouble. You can get into the sort of poverty trap where the profits begin to decline; therefore internally generated funds are not available for investment; the company cannot then raise external finance; it is difficult to attract good management and it goes downhill. I do not think the City at the moment is terribly good at knowing how to deal with those situations. Some of the companies mentioned . . . are companies of that type where we needed an external agency to pick the thing up and analyse it and find out what was wrong and ensure that the changes were made, and I think the NEB is able to perform that role. There is an institutional shareholders' committee in existence but I do not see it actually performing that role in the same way, and I think this is something the City should reflect on" (*Evidence on the Financing of Industry and Trade*, Vol 4).

This is, of course, not a new problem, and many commentators have written about it. The usual solution put forward is an increased role for non-executive directors. But the role of a non-executive director invited onto the Board by the Chairman is not an easy one. Apart from their personal ties to the Chairman, there is the fact that they cannot, without support from elsewhere, know nearly as much about the business as the Board. Also, if in the last analysis they do feel that the Chairman or chief executive needs to be changed, they have no way of doing much about it. Equally, there is really very little the individual shareholder can do other than sell his shares. In fact, until the institutional shareholders begin to feel that they have a responsibility for the companies in which they have invested, and until they are prepared, if necessary, to put representatives onto the boards of companies, it is very unlikely that any solution will be found to this problem.

investment led growth

Fourth, we need to consider the effect that

our methods of funding industry have on our ability to achieve investment-led and export-led growth (the two are obviously closely related) rather than consumption-led growth. The reason for trying to achieve investment-led and export-led growth is quite simple. Stimulating the economy by cutting personal taxation inevitably leads to an increase in the purchase of consumer durables out of the increase in disposable incomes. In Britain, because so many consumer durables are imported, this immediately results in a surge of imports, and, because capacity has not been increased, also to inflationary pressures. In the case of investment-led growth, while an increase in investment does generate higher incomes and increased spending in due course, productive capacity is growing in parallel with it.

It is this need for investment-led and export-led growth which makes the present policies of the Tory Government so totally incomprehensible. There is an urgent need now to restructure our industries so that they produce the range of goods that we choose to buy out of increases in our incomes. But if we want to achieve such a restructuring, then we need to invest heavily now not only in new plant and equipment but also in investigating new markets and developing new products for them. But the fierce monetary squeeze now being inflicted on industry by the government is likely to achieve exactly the opposite effect, with companies cutting back on capital investment and new product development as they struggle to survive. Even if the squeeze on money does eventually bring down inflation, and this seems very remote without a devastating recession, industry will be in no position to benefit from any upturn. The present Tory Government claims to be concerned with supply-side economics, but their policies suggest an almost total ignorance of the factors which effect the ability of British industry to compete.

If we want to achieve investment-led growth, then we need to get companies to invest counter-cyclically, but this is very difficult given our financial system.

In Britain a company can usually only obtain additional finance by making additional profits. To the extent that these earnings are retained in the business, they increase the equity of the shareholders and this can be used to justify further debt. To the extent that they show that a company is performing well, they also make it easier to raise funds by having a rights issue. Such a system unfortunately makes it hard for industry to invest heavily during a recession. It also has lag-lead characteristics which mean that industry cannot quickly respond to an upturn in demand. It is probably right to see supply rather than demand as the main problem facing British industry today, but in this case this argues for greater government intervention in industry rather than less.

taxation and savings

It can be seen then that the system for channelling funds to industry in this country does not meet very well our first criterion that it should direct the available funds to the right companies and industries. How then does it measure up to our second criterion, namely, that the supply of funds and the cost of capital should be at levels which are desirable from an economic policy viewpoint? This is clearly a very difficult question to answer, but one point needs to be made very strongly. In spite of all the emphasis in recent years on the need for greater industrial investment, the tax system in this country still gives much more favourable treatment to various other forms of savings than it does to savings made available to industry.

The three kinds of savings which receive particularly favourable tax treatment are investment in owner occupied housing, pension funds and life insurance. In the case of owner occupation, relief is given at marginal rates of income tax for interest payments on loans of up to £25,000 for the purchase or improvement of a borrower's main residence.

This tax relief cost the government £1,450 million in 1979-80. In fact, of course,

the relative tax advantage of owner occupiers is greater, as nowadays owner occupiers do not have to pay any tax on the imputed benefit arising from owner occupation as they used to under the old Schedule A income tax system. The effect of this tax relief is, of course, to push up demand for a limited supply of houses, with the result that prices have risen more than otherwise would have been the case.

In the case of pension funds, they also benefit in a number of ways. Firstly, provided a fund is approved by the Inland Revenue, pension contributions of both the employer and the employee are excluded from income. A similar relief for the purchase of an approved retirement annuity is also given to the self-employed. Secondly, no tax has to be paid on the investment income or capital gains of an exempt fund. And, thirdly, while payments out of such a fund are taxable in full as earned income, up to $1\frac{1}{2}$ times final pay may be taken at the time of retirement as a lump sum free of tax. The cost of this relief to the government is calculated to have been £500 million in 1979-80 for pension schemes and £110 million for self-employed retirement annuities.

Finally, in the case of life insurance, personal relief is given for qualifying premiums up to a limit of the greater of £1,500 or one-sixth of an individual's total income. Premiums are paid by the policyholder net of a deduction of $17\frac{1}{2}$ per cent (15 per cent with effect from April 1981) and this amount is then paid to the insurance companies by the Inland Revenue. The cost of this relief to the government is estimated to have been £430 million in 1979-80.

As a result of the favourable tax treatment they receive, these three forms of saving have risen as a proportion of personal wealth from 40 per cent in 1957 to about 63 per cent in 1973. And there is nothing inevitable about this change. In the USA in 1973 these three forms of saving accounted for only about 39 per cent of personal wealth. Equally, life insurance in the USA which has very

limited tax advantages accounted for only about 6 per cent of personal wealth in 1973, while life insurance in Britain accounted for nearly 11 per cent.

There are two reasons why this trend has an unfavourable impact on industrial investment. In the first place, in the competition for funds industrial investment is put at a disadvantage. Indeed it may be this factor which explains the extraordinary paradox that industrialists will argue strongly, and largely for political reasons one suspects, that there is no shortage of funds for industry, while maintaining equally strongly that public expenditure crowds out industrial investment. The answer is, of course, that funds are always available at a price, but that the price that industry has to pay is made higher by the favourable treatment given to other forms of savings.

Secondly, for a number of reasons the institutions that benefit from this favourable tax treatment are not very good vehicles for channelling funds into industry. In the first place they are faced by a number of legislative restrictions. The building societies, for example, are barred from making any equity investments at all. In the second place they prefer to invest in companies where they can build up a shareholding of £100,000 or more. Individual shareholdings of £100,000 or more, for example, represented almost 90 per cent of the value of equities held by insurance companies in a recent survey. The reason for this bias is largely administrative. Such institutional investors have a fairly small number of people to invest their money, and these people have to look not only at stock exchanges in London and abroad, but also at commodities, gilt-edged securities, office properties and agricultural land as potential means of investments. This means that they like to make their investments in large tranches and that they have little time to evaluate or monitor seriously companies or industries. There is also almost certainly a problem of communication, as it is the banks with their branch networks who hear of the financial needs of small businesses rather than institutional investors. Thus a sub-

4. government aid and intervention

stantial bias against small businesses results from the dominance of institutional investors, nor do institutional investors have the industrial knowledge to properly evaluate, monitor and, if necessary, rescue companies.

It can thus be seen that the system for funding industry in this country is not well suited to the urgent task of restructuring industry. It may have worked well when the speed of technological change was slower and less risky, and when the scale of resources needed was less, but it is not well suited to circumstances today. It is also no good saying that the system would work well if companies were only more profitable, though this would obviously help a great deal. As B R Cant wrote: "Firstly the appropriate scales and concentrations of activities have to be created, which involves immense initial capital re-equipment out of phase with performance, and secondly it is essential to recognise that it is not management omniscience that counts, but rather the paradox that in a world of rapid technical change it is necessary to have adequate resources to take the long view on market development, new products and investment, particularly when the immediate situation looks gloomy" (*Britain's Economic Problems In International Historical Perspective*, Centre for Business Research in association with Manchester Business School, 1972).

If the system for channelling funds to industry is not working well, then clearly government should seek to rectify the situation, and a considerable number of attempts have been made in recent years to do so. Before developing any new solutions it is obviously sensible to look closely at these previous attempts of government, partly because there are important lessons to be learnt, and partly because it must be right where possible to build on the successes of the past, rather than endlessly trying to create dramatic new solutions.

There are a number of ways that government has sought to aid industry. Firstly, it has done so directly, and the government now has considerable powers to do so under the Industry Act 1972 and the Science and Technology Act 1965. For example, under Section 8 of the Industry Act the last Labour Government gave help to industry by means of such general schemes as the Accelerated Projects Scheme and the Selective Investment Scheme. The Accelerated Projects Scheme, which ran from April 1975 to July 1976, was introduced in order to bring forward investment counter-cyclicly, and 113 projects were assisted involving £72 million of assistance and £571 million in project costs. It was followed in December 1976 by the Selective Investment Scheme which ran to June 1979 and which was introduced in order to stimulate investment projects which would yield significant benefits to the economy. By the end of March 1979, interest relief grants totalling £76 million had been offered for 115 projects involving capital outlays of £756 million, including working capital of £137 million.

Also under Section 8 several schemes for particular sectors were introduced in consultation with the industries themselves, to encourage modernisation and rationalisation. These included such schemes as the Off-Shore Supplies Interest Relief Grant Scheme, the Wool Textile Industry Scheme, the Ferrous Foundry Industry Scheme, and the Machine Tool Industry Scheme. Finally, under the Science and Technology Act 1965 the government has wide powers to support R and D. This is

the Act under which research is provided in support of industry at universities, government establishments and research associations.

The benefits and importance of these schemes should not be underestimated, but two brief comments need to be made about them. The first is that they mostly seem to have been developed on an *ad hoc* basis with little consistent strategic thinking. And, secondly, few of the schemes have been varied in response to the different competitive dynamics of the various industries they have covered. Their impact has, therefore, probably been less than it should have been.

the national enterprise board

The second way the government can provide financial assistance to industry is through specialised agencies in the public sector, such as the National Enterprise Board, the Scottish Development Agency, the Council for Small Industries in Rural Areas, the Highlands and Islands Development Board, the Welsh Development Agency and the National Research Development Corporation. The most important example of these is the NEB, and it is worth examining in some detail its record. While the original idea of controlling the "commanding heights" of the economy was never implemented and the opposition of industry was considerable, the NEB, in the period up to November 1979, managed to tackle a number of key problems and to earn the grudging respect of industry. When the Board of the NEB resigned in November 1979, it handed over shareholdings, other than the huge investments it had inherited in BL Ltd (formerly British Leyland) and Rolls Royce Ltd., in 67 businesses with a book value of £155 million.

In terms of its impact on the economy it must, therefore, be considered of marginal significance, but as an example of how the public and private sectors can work together it is clearly of very great importance.

The work done by the NEB can be classi-

fied under five headings, namely, the support of small businesses, the strengthening of key industries, the management of the problem companies which it inherited, the provision of help for regional development, and the stimulation of exports. As most of the investments it has made are long term ones, it will not be possible for a number of years to make any proper judgment on the work it has done, but it is worthwhile to examine closely what it has achieved in each of these areas.

In supporting small businesses, the NEB made about 50 equity and loan investments, averaging about £300,000 each. A number of these, such as Pitcraft Ltd., R R Chapman (Sub-Sea Surveys) Ltd., and Agemaspark Ltd, have obviously been extremely good investments. On the other hand, a number of the small companies in which the NEB had a stake have been put into receivership since the new board took over. Overall the NEB investment in small businesses seems to have achieved a reasonable ratio of successes, and the fact that some companies which can now clearly be seen to be successful have found it necessary to go to the NEB for funds should raise queries in the minds of those who believe that all viable investment projects will easily get funding from the private sector.

the strengthening of key industries

In the second area, the strengthening of key industries, the NEB has also taken a number of useful initiatives. Having examined the reports of the National Economic Development Office (NEDO) Sector Working Parties, and done some work of its own, the NEB concentrated on a number of sectors, namely, automotive products, aero engines, computers and electronics (including software), machine tools, scientific and medical instruments, office equipment, process control, telecommunications, power plant manufacture, construction and mechanical handling equipment, industrial engines, hydraulics, electronic test and measuring instruments, and off-shore

engineering. Thus the NEB in 1979 took the lead in setting up a new plant to manufacture titanium sponge to meet the future needs of Rolls-Royce, though Rolls-Royce later bought out the NEB stake after it had become fairly clear that the project was likely to be a success. Then again, in 1979 the NEB made a substantial equity investment in a high technology company called British Underwater Engineering Ltd, which was established to provide integrated underwater engineering services in the North Sea and elsewhere, and to manufacture related equipment. A third example of its work in this area was the announcement in 1980 that the NEB and four City institutions were collaborating in the setting up of Celltech, a new company launched to exploit biotechnology.

But most of the major initiatives of the NEB in the field of strengthening key industries were taken in the area of computers and micro-electronics. If the UK is to become a high wage and fast growth economy, it is essential that it moves out of labour intensive low growth industries into high value-added growth industries like computers and micro-electronics. It had become clear, however, that the private sector was not moving resources into this area vigorously enough. Apart from ICL (which would not have existed without £40 million of "soft" loans from a Tory Government), the British computer and office systems industry is fragmented and this market can only be entered by companies which are large enough to invest heavily in research and development, marketing and a wide product range. The NEB therefore set up three completely new subsidiaries, INMOS, INSAC and NEXOS. INSAC was formed to provide overseas marketing and development funds to the computer systems and programming companies with which the NEB already had links. NEXOS was formed to coordinate a marketing and development drive in the office equipment market, and INMOS was set up to make microelectronic chips.

These are all clearly long-term investments, and again it will be some time

before their profitability can be properly assessed, assuming, of course, that the present Conservative Government allows them to continue. Two points need, however, to be made in connection with these investments. Firstly, in the NEB an effective instrument of intervention seems to have been found. And, secondly, even if there had been a flourishing industry, it is doubtful if the Government could have stood back. As Dr I M Mackintosh, the Chairman of Mackintosh Consultants Co wrote: "The most basic fact about the electronics industry today is that—possibly more than any other—it is totally international in character; for example, so great is the importance of such factors as economies of scale, amortisation of high R and D costs, etc., that few electronic products can produce adequate corporate profits unless marketed vigorously on a global scale. It follows, therefore, that if Britain's competitors effectively subsidise their own national electronics industries (which they will undoubtedly continue to do on a massive scale), thus distorting free market forces and normal competitive conditions, we must either do the same or sit back and witness the inevitable decline of our national electronics capability" (letter in *Financial Times*, 25 July 1979).

While it is not possible at the moment to assess properly the major investments the NEB made in INSAC, NEXOS and INMOS, it is possible to comment on the performance of the software companies in which the NEB took a stake. In 1977 and 1978 the NEB invested in four software companies, as part of the setting up of INSAC, namely, Computer Analysts and Programmers (Holdings) Ltd., Systems Designers International Ltd., Systems Programming Holdings Ltd., and System Ltd., and then in 1979 it took a shareholding in Logica Holdings. These investments are of particular interest, because it was almost certainly the activity of the NEB which created an interest in software companies, which previously the City had not thought good investments. Equally, in all cases these companies have shown huge increases in their sales, and in most cases profits have grown substantially as well.

Logica Holdings : a case study

It is also worth looking in more detail at one of the companies in this group, namely, Logica Holdings, as it illustrates very clearly many of the points made in this pamphlet about the financing of industry. An article in the *Guardian* (23rd October 1979) described the history of this company which was set up in 1969.

The funding sought to start the company was £100,000. Two points need to be made about their business plan. The "worst case" cumulative loss forecast was £40,000 at which point the business could be wound up. Secondly, very little fixed capital was required, the majority of the money being to fund receivables, as the average time between doing work and being paid in this type of business is three months. Attempts to raise this backing in this country failed, though it was a time when Americans were investing heavily in software companies. In the end, the Chairman managed to get funding of £100,000 from an American conglomerate, the Planning Research Corporation, who took shares in Logica. The performance of the company with this funding was extremely good, and it expanded profitably at some three times the projected rate in its plan.

In a memorandum he wrote for the Wilson Committee, Logica's Chairman made two extremely important points about their experience. The first concerns the lack of technological expertise in the financial institutions. "The financial institutions approached lacked any meaningful expertise to judge the technology of the business proposal. This particular experience can certainly be widened even today to the general statement that few financial institutions have the expertise of technology in-house to make the required analysis. This would matter less if they sought consultancy outside from people expert in the technologies. We, as a company, do not expect to have internal experts on taxation, exchange control and associated financial matters. We pay City institutions for consultancy in areas that are their speciality when we have

to make such financial assessments. The reverse seldom applies. Consulting on technology still usually means asking a few contacts for an off-the-cuff assessment. We know, because we get asked, but our reply is always that if the question is serious then it merits serious study however brief, and not just a reply over the telephone.

Our experience in comparing UK with US financial institutions is that those in the United States are both more experienced in technology—they have full-time experts—and are more prepared to seek outside professional advice as well.”

Logica's Chairman also argued in the same memorandum that the entrepreneur when he negotiates with a potential financial backer must seek a share of the equity which will give him the opportunity to make a substantial profit if the venture is a success. His experience, however, was that the financial institutions in such circumstances would always seek control, looking in a one class structure for at least 50 per cent of the equity. The result is that “the terms on which capital is available to the entrepreneur are too often just not sufficiently attractive to warrant the vast efforts that he must make, and the risks he must take, to ensure success.”

The story of the Logica Group also has a sequel. In 1978 Logica decided that it wanted to buy out its American parent. By this time its sales were over £10 million and its pre-tax profit over £900,000. Again it went to the City, only to find the situation much as before. It was then that it did a deal with the NEB which had first approached the company as part of its NEXOS initiative. The Planning Research Corporation's shares were bought out for \$8 million, and the NEB subscribed for 20 per cent of the shares of the company, leaving 51 per cent owned by the staff shareholders, and providing Logica with a bridging loan for the remaining 29 per cent whilst the company sought additional private sector finance. In the following year four private sector institutional investors subscribed for shares, so that now the company is

jointly owned by staff shareholders, private sector institutions and the NEB.

companies in difficulties

The third area of work of the NEB, and the one which has unfortunately attracted the most attention, is the rescuing of companies which have got into difficulties. There are two questions which need to be asked about this type of work. The first is whether such rescues should take place at all and, if so, under what circumstances. The second question is what is the best method of carrying out such rescues, assuming that it is desirable that they should take place. The first question can best be examined by considering two such rescue attempts, namely, the attempts to save Ferranti and Alfred Herbert. The government came to the rescue of Ferranti in 1974, when the National Westminster Bank refused to extend its overdraft facility, and no other private sector rescuer was prepared to help. The Government injected £15 million into Ferranti, of which £6.3 million was in loans and the rest in equity, amounting to 62.5 per cent of the total. It undertook then to reduce its shareholding to 50 per cent, which it did in September 1978, by selling part of its interest to existing shareholders. After a small loss in 1975, the profits before tax of the company have steadily grown from £4.1 million in 1976 to £11.2 million in 1980. In July 1980 the NEB sold its 50 per cent stake for £54 million. It is impossible to regard this as anything other than a very successful piece of state intervention.

In contrast, the attempted rescue of Alfred Herbert must be rated a total failure. In 1974, the Industrial Development Advisory Board, the group of businessmen who advise the Secretary for Industry on aid applications under the 1972 Industry Act, recommended that the company should go into receivership. The government, however, decided that it was right to provide the company with further funds, and in December 1975 the company was taken into public ownership. A total of £44.5 million was injected into the company, but by the middle of

1980 it was clear that it could not hope to survive. It is clear, therefore, that the advice of the Industrial Development Advisory Board should have been followed in 1974.

What lessons can be learnt from a comparison of these two rescue attempts, one a considerable success, the other a total failure? In the case of Ferranti, the company had a considerable reputation for technological excellence, and it was a disregard for financial controls and profitability that led to its problems. It was thus possible to turn the company around by injecting in new top management, who then installed a new system of strict financial reporting and control. The situation of Alfred Herbert was very different. For a long period it had suffered from a disastrous lack of investment and unwillingness to innovate. The result was that its product range by 1975 was totally out of date. Equally, most of the money which was injected into the company by the Labour Government went to replacing private sector debts and a stockbuilding scheme, and very little to modernising the group's equipment and product range. Thus, it was inevitable that eventually the company would collapse, and it is perfectly reasonable to argue that more jobs would have been saved if the company had gone into receivership in 1974.

The lesson of these contrasting rescue attempts is thus fairly clear. If a company gets into financial difficulties, but basically has a sound product range and the necessary production and distribution arrangements, then a rescue attempt should be made if the private sector does not step in. It should be pointed out again, however, that any competent banking system will make the attempt itself. If, however, a company no longer has a viable product range or the production and distribution facilities to make and sell it, then it may be better for the company to go into receivership, so that the viable parts of the company can be saved and the other assets used for different purposes. The main theme of this pamphlet is that state intervention should be used to hasten the process of industrial

restructuring and not to hinder it, and rescue attempts must be examined against this criterion also.

The second question which has to be asked about rescue attempts by the government, is how are they best carried out. And here the record of the NEB is very instructive. There are two possible reasons for having a para-governmental agency for intervening in industry rather than the Department of Industry. The first is that it can act in a more commercial manner. Civil servants are unlikely to have the skill and experience to make the decisions involved, and it is unlikely that a government department can ever be as flexible and urgent as such an agency. Also in many cases actions will have to be taken on the basis of judgment rather than hard facts, action which it may be difficult to justify either contemporaneously or retrospectively. Such action is not something that appeals to civil servants. The second reason is that there is likely to be a much clearer allocation of responsibility. The time scale of most industrial decisions is likely to be long, while the period of office of most ministers is likely to be short. A para-governmental agency with a continuous existence is much more likely to take a long-term view than a minister subject to political pressures who will very likely not be in office when the results of his decision appear.

The record of the NEB when in office gives weight to these arguments for a para-governmental agency. The Board stood up to the government over the proposal to keep open the Scottish plants of Prestcold, and, where necessary, it showed itself capable of taking firm action when it became clear that companies were no longer viable. The Sinclair venture was run down, British Tanners Products was put into receivership and Cambridge Instruments reconstructed to bring in new private sector involvement. Equally, when the top management of BL Ltd was clearly not coping with the problems, a new management was brought in to take charge.

Finally, in the case of Rolls-Royce, the

Board of the NEB sought to remove the Chairman, Sir Kenneth Keith, when he refused to permit an examination of the serious financial performance of the company. This sort of critical analysis of the performance of management is something which has been far too often lacking in both the public and private sector, and the behaviour of Sir Keith Joseph in refusing to support the Board on this issue, and in returning the control of Rolls-Royce to the Department of Industry, seems at the best a return to the philosophy of doling out huge sums of money to private industry without any proper analysis or surveillance. At the worst it appears utterly unprincipled and self-serving.

regional development

The fourth area of work of the NEB which needs to be evaluated is its provision of help for regional development. In 1977 two regional Boards were set up, one called the Northern Regional Board covering Cleveland, Cumbria, Durham, Northumberland and Tyne-and-Wear, and the other called the North West Regional Board covering Cheshire, Greater Manchester, Lancashire and Merseyside. These Boards have delegated authority to approve investments of up to £0.5 million each, and each has made a number of investments. But their formation seems more to have risen from political expediency than any serious consideration of the structure of government.

It should be noted however, that the NEB's policy of not considering investments much below £100,000 clearly limits its scope in this area, as does the number of staff it employs. In recognition of these limitations perhaps, two associated companies were set up. The first of these, Newtown Securities (Northern) Ltd was incorporated in 1978 and is an equal joint venture between the NEB and the Midland Bank Ltd. Its purpose was to make available unsecured loans for amounts between £5,000 and £25,000 to small companies, as well as equity options in appropriate circum-

stances. In the first 18 months of its existence it only made two investments. It is thought likely that the NEB will shut it down soon, transferring the businesses to the bank's direct care.

The second company is Sapling Enterprise Ltd which was formed in 1979 by the NEB and Collinson Grant Associates, a Manchester based firm of management consultants.

The idea behind this company was that it would help selected smaller companies with major growth potential to cope with the problems associated with rapid growth. The Sapling Scheme will be operated on an experimental basis in the North West Region, and during the experimental period it will be limited to ten companies in each of which the NEB has agreed to invest at least £50,000. In the first year of its existence it made three investments, and it is judged to have been a success. It should be said, however, that the setting-up of the two Regional Boards and the two associated companies does not add up to a very significant initiative in terms of solving the serious regional disparities that exist in this country.

exports

The fifth area where the NEB was given a job to do was the stimulation of exports and a number of small initiatives have taken place. INSAC has already been mentioned, and in 1979 the NEB invested in a new company called Middle East Building Services Ltd, in an attempt to make it possible for the UK's building materials industry to gain a greater share of Middle East trade. Equally, in the same year the NEB with 11 other companies set up Momex (UK) Ltd. This company was established to encourage the export of mechanical handling equipment to Venezuela, and a full time representative was established in Caracas to help win orders for its member companies by channelling enquiries to the UK and by supporting members when they tendered for contracts. Venezuela is regarded as a prime market for conveyor companies because of its con-

siderable mineral resources and its oil revenues which are likely to speed up their exploitation, and a joint venture such as this is considered sensible because it provides substantial cost benefit advantages.

The NEB was also responsible in 1978 for rescuing Allied Investments Ltd when it got into financial difficulties and for merging it with its own subsidiary United Medical Co International Ltd to form United Medical Enterprises Ltd. United Medical Co International Ltd had been set up in 1977 by the NEB to act as a wholesaler of UK medical supplies overseas. Since its formation the new company has clearly done extremely well, its sales rising from £10.2 million in the year to 31 December 1978, to £19.7 million in the following year, and profits rising from £0.83 million to £2.38 million over the same period. These initiatives have all been quite useful, but despite vigorous efforts the NEB managed to do little to help system sales and whole plant sales abroad. This is a significant failure, because, as has been pointed out earlier, this is an important growth area, particularly in fields such as airport development where we should do well. It is also an area where governments in other countries often play a substantial role.

In reviewing the work of the NEB what lessons can be learnt? In the first place, the work of the NEB demonstrates very clearly the need for industrial banking in the UK. Secondly, as the major instrument of the last government's industrial policy, the NEB pursued a wide range of initiatives. While its work in rescuing companies and its development of strategic industries can as a whole be counted a success, its support of small businesses and regional development have not been so effective. As far as the stimulation of exports is concerned, judgment probably needs to be reserved. The area, however, is such an important one that a future Labour Government should try to encourage the NEB to develop a role in this area.

In seeking to learn from the past initia-

tives of development agencies, the NEB is the obvious place to turn to first. But the record of other bodies needs to be examined as well. In particular there are lessons to be learnt from the performance of COSIRA over the years. COSIRA was formed in 1968 to support employment in small firms in rural parts of England, and it provides technical and business management advice, training and loans for industrial and tourist projects employing up to 20 skilled workers in rural areas and country towns not exceeding 15,000 inhabitants. It is organised on the basis of counties or groups of counties, with local committees, and it puts a lot of emphasis on the advisory side of its work. It is very much an industrial bank and its record has been outstandingly good. Even though it has been very involved with start-ups, which are always extremely difficult, by March 1978 only £41,000 or 0.2 per cent of its total advances had been written off. It now is actively helping some 11,000 small businesses employing more than 70,000 people, and it was the only lending institution that reported to the Wilson Committee that it was short of funds in relation to the demand.

planning agreements

Finally, to be complete, an examination of recent efforts of government to aid or intervene in industry must include a discussion of planning agreements. In contrast to the NEB, the concept of planning agreements has so far led to nothing, other than the planning agreement concluded with Chrysler in 1977. This was partly due to the unrelenting opposition of industry, which was to a great extent political. At the same time, there were a number of flaws in the concept of planning agreements which were fairly obvious from the start. The first was the idea that government had the capability to handle them. While the Department of Industry is probably better able now to deal directly with industry than it was in the past, the fact remains that there are not people there who are capable of making a sensible contribution

5. a new partnership

to the investment or product development plans of, say, ICI or Unilever. One has only to look at the telecommunications side of the Post Office where the government over the years ought to have intervened in their product development plans in order to help the export prospects of the Post Office's suppliers, to see that this is so. This is obviously something which could possibly be put right, but whether it could ever be done on the scale envisaged by the original proposers of planning agreements is very doubtful.

Secondly, while the government said that the production of planning agreements would be conducted so as to incur the minimum of extra administrative cost of the companies (*The Contents of a Planning Agreement—A Discussion document*, The Department of Industry, 1975), there is no doubt that they would have placed an additional new burden on industry, with no obvious benefit for government or industry in sight. It is obviously right if government provides aid to industry for it to seek by appropriate means to make certain that such aid is used to best advantage. For example, the NEB in providing equity for unlisted companies has obviously sought to protect its position when it has been a minority shareholder by having a Shareholders Agreement. It is also a major argument of this pamphlet that shareholders, whether they be individuals, banks, institutions or the NEB, should seek to monitor more closely the performance of their companies, and to take appropriate action if that performance is poor. And the government should do everything it can to improve this system. What it should not seek to do is to overlay this system with an additional ineffective system of evaluation. The idea of civil servants sitting in Whitehall second-guessing management without either any responsibility for the results or, indeed, any method of correcting the situation if the performance is poor, is hardly one likely to lead to an improvement in the efficiency of British industry.

It goes without saying that the situation

would only be worse if planning agreements were made compulsory. What happens, for example, if a company is forced against its will to develop a new product or to open a new factory, and the project fails badly? Does the government have a responsibility to compensate the company, or indeed to save it from liquidation and the workers from redundancy if that is the likely result? It is difficult to see a situation which could lead to a greater confusion of responsibilities.

Finally, it needs to be appreciated that large companies are becoming increasingly diversified while planning by government is likely to focus on an industry or business sector. Indeed the industrial strategy of the last Labour Government developed into entirely a sectoral approach. It is thus always likely that government will only be able to make a sensible input into some parts of diversified companies' plans.

It can be seen then that the past efforts of government to aid and intervene in industry have important lessons when it comes to the development of policies for the future. There are two main lessons. They are, firstly, that a body such as the NEB can play a useful role as an industrial bank for high technology projects, for the rescue of companies, and potentially for the stimulation of exports. And, secondly, that while planning agreements might have a limited use, it is impossible to see how they could be used as a general instrument to increase the efficiency of British industry or to compel companies to follow corporate plans against their will.

Industry in this country today is faced with severe competitive pressures from abroad, and in dealing with them is greatly hindered by its low productivity and profitability. If it is to survive and grow, it will require substantial help from the financial system which the latter is not well placed for historical reasons to give, in spite of some useful government initiatives in recent years. In these circumstances, can we learn anything from the way other industrial countries manage their economies?

If we look at Japan, Germany or France, we see a very different approach to the extreme philosophies advocated in this country. In particular two points are worth noting. In the first place it is accepted that industry and government must work together in partnership to restructure the economy. The collaboration between the Ministry of International Trade and Industry (MITI) and Japanese industry is well known, but in Germany also, for example, there is a flourishing partnership between industry and government. Not only do quite a few companies have the government as a shareholder, but there is also a wide range of publicly owned financial institutions which support industry at federal, state and municipal levels. Finally, as we have seen, there is the work of the *Bundesminister für Forschung und Technologie*, which is the channel for the increasing government support to high technology businesses, and which works closely with industry.

Secondly, in these countries the role that the government is seen as playing in this partnership is a strategic one. Government is not seen as an alternative to industry, nor as having primarily a regulatory role. Rather government is seen as having a leadership role, with implementation being left to individual businesses. The reasons for the prevalence of this approach abroad have been well expressed by Maurice Marks, who was Planning Director of the NEB for three years. "There is, of course, no way in which a modern industrial economy can be planned in the simple physical sense that planning is normally used in politi-

cal debate. At the heart of all economic activity lies the fact that the future is not knowable. Uncertainty is not a peripheral problem but the central problem. There is no way in which the economy can be managed save by a very elaborate decision-taking process based on the price mechanism, working through a large number of markets which link the product with the reality of consumer preference and the gradual process of industrial change and innovation" M Marks, "State and Private Enterprise", *The Business Economist*, Spring 1980). But as he went on to point out, the market may not work as well in the creation of new industries as it does in stimulating the efficient production of current products and services, and, therefore, the government has a major and continuing role in stimulating economic growth.

lessons from Japan

The Japanese economy is probably the best example of how a government can operate at the strategic level. Japan is described by MITI as having a "plan-oriented market economy", and an outside observer has aptly described it as "guided free enterprise". A striking feature of Japanese industrial policy is, in fact, the way that the government has managed to combine competition and co-ordination. In the steel industry a large number of selective measures have been carried out without restricting initiative, and even capacity expansion co-operation has not been allowed to restrict competition or hinder market share changes (Ira C Magaziner and Thomas M Hout, *Japanese Industrial Policy*, PSI No. 585). Equally, in the field of information electronics, co-operative research and development work has been combined with competition in marketing and application engineering. In the first, obviously the pooling of resources can give useful benefits, while in the second it is more important to preserve the vitality of competition. The Japanese Government has, in fact, not been inhibited by political considerations from using whatever

combination of private and public investment it has thought correct to promote the long-term interests of Japanese industry.

It is important to understand that it is implicit in such an approach that different strategies need to be developed for different industries, a point which has obvious implications for the way government is organised, and the skills it requires to have. As Christopher Freeman has said "Almost all sectors of the British economy have shown some competitive weakness, and improvements are needed across the board. To this extent general arguments for protection or competitive devaluation have some validity. However, experience has shown that these strategies have not solved the more fundamental long-term supply problems affecting all sectors of British industry. The foundation of a good long-term techno-economic strategy must affect the entire economy, with a whole battery of specific instruments designed to cope with the individual problems of each specific sector" (Editor Keith Pavitt, *Technical Innovation and British Economic Performance*, Macmillan, 1980). And here again the Japanese can teach us something. There are two aspects of the Japanese system in particular from which we could almost certainly learn something. The first is the impressive way in which MITI, in keeping with the clear understanding the Japanese have of the life cycle of industries, varies its intervention according to the stage that an industry has reached in that life cycle. In the early growth phase, MITI will seek to protect the industry from foreign competitors, encourage producers to merge into internationally viable units, give help to the industry with its cash flow and stimulate new technology. When industries reach the stage of being internationally competitive and growing fast, then MITI stops intervening. Finally, when industries cease to grow and be internationally competitive, MITI will intervene again to help reduce the industry to a viable size. The instrument which MITI has to help it in this last phase is the Structurally Depressed Industries Law passed into law by the Diet in 1978.

This law enables the relevant Ministry to develop a stabilisation plan for the industry, involving the scrapping of excess capacity and where real financial hardship exists, the provision of a loan guarantee trust fund in order to get private banks to extend further credit to companies which are in trouble.

The second aspect of Japanese industrial policy which we should almost certainly copy is the way in which government measures to help industry have been specifically and carefully matched, not only to the micro-economics of different industries, but also to the challenges and changes which the different industries have had to face in the marketplace. For example, in the field of information electronics, help has been directed to a huge research and development programme, and to giving help to buyers of computer equipment. In the early 1960s it was decided that IBM was achieving a competitive advantage over its Japanese competitors who were short of cash by leasing rather than selling computers. MITI, therefore, arranged for a joint venture called the Japan Electronic Computer Corporation (JECC) to be set up with funds largely provided by the Japan Development Bank. JECC has the function of buying computers from the manufacturers and leasing them to customers.

There is nothing which would appear to be uniquely Japanese about any of these initiatives, unless it is competence and economic realism, and there is no obvious reason why we should not learn from them, unless it is arrogance and a dislike of change. A start along the right lines was made in the 1975 White Paper *An Approach to Industrial Strategy* (Cmnd 6315, HMSO), probably the most sensible White Paper on industrial policy in recent years, but in the end there does not seem to have been enough commitment on the part of the government, or enough expertise within the government machine, to turn the ideas set out in the White Paper into action. In the meantime huge sums of money were poured into industries which could not hope to survive in the UK in the face of international competition, while not

nearly enough effort was put into supporting those that could hope to do so.

The first priority of the next Labour Government must, therefore, be to develop this sort of strategic thinking in collaboration with management and trade unions. Unless such a framework is developed, changes to the system of financing industry will be taken in a vacuum and are likely to be ineffective. Having developed a strategic framework within which to work, there are then a number of steps which the government should take in partnership with the financial institutions to improve the funding of industry.

a new bank

A convenient point to start when looking at improvements to the funding of industry is the role of the different agencies of government. If one looks at how they have performed in the past, then three points emerge very clearly. Firstly, the NEB, as we have seen, has done quite well as far as the strengthening of key industries is concerned, and also in the management of problem companies. Equally, it has made a start in the much harder task of stimulating exports. Under a future Labour Government, its role in these areas should, therefore, be confirmed and strengthened, though as has been argued earlier, much tighter criteria need to be set for the rescue of problem companies. There is still a need for more risk money to be put into building up new industries, and for Government to play a more active leadership role in attempts to gain key export orders. Equally, until the financial institutions redefine their role with regard to companies in difficulties, there will be a need for the government to intervene in certain circumstances. In the case of regional policy and the support of small business, the performance of the NEB has, however, been less successful. The second point which emerges is one made by the Wilson Committee report (Cmnd 7937, HMSO, 1980), namely, that there is now a serious discrepancy between the arrangements to help small businesses in

England as compared with the rest of the United Kingdom. The development agencies in Scotland, Wales and Northern Ireland, namely, the Scottish Development Agency, the Highlands and Islands Development Board, the Welsh Development Agency, the Development Board for Rural Wales, and the Local Enterprise Development Unit in Northern Ireland, are able to help small businesses by providing them with equity as well as loan capital. In England on the other hand, other than the NEB, there is only COSIRA which is restricted to rural areas, cannot give equity, and whose loans are limited to £50,000 to any one business. Thirdly, there are a range of banking functions which one would like to see the government perform, which are, however, probably best carried out outside the Civil Service, and which certainly ought to be carried out on a regional basis. These three factors point to the need for a new institution, an English Industrial Development Bank.

Before spelling out the precise tasks the English Industrial Development Bank should perform, there are a number of general points which should be made about the way it should operate. Firstly, it should have a statutory regional basis so that the services it offers industry can be varied on a regional basis. The alternative is regional development agencies.

The possible setting-up of these was put forward in the consultative document *Devolution: The English Dimension*, while the 1979 Labour Manifesto promised to create similar development agencies to the Scottish and Welsh Development Agencies in the "English regions suffering similar problems". A single agency with a statutory regional basis would, however, seem a better solution, as it would be less likely to lead to a large bureaucracy, and less likely to result in fruitless competition between the different agencies.

Secondly, it would be essential for the English Industrial Development Bank to be staffed with people with industrial experience. Almost by definition the companies it would be dealing with

would be ones which would have to be judged on a "going concern" basis rather than a "liquidation" basis, and it would thus inevitably have to be making judgments about the capabilities of the top management with which it was dealing, and with the technical and commercial viability of the products being manufactured. Also, as was pointed out in the Wilson Committee report, the shortage of demand for finance is a major part of the problem. One wants, therefore, an agency which actively seeks out and promotes new projects and new firms, rather than one which waits passively to be approached. This is, of course, much more likely to happen if such an agency is staffed by people with an industrial background.

Thirdly, it would be essential for the new body to work as far as possible through other bodies such as the branches of the clearing banks, the numerous enterprise agencies and trusts that have sprung up around the country, ICFC and other financial institutions. This would be in keeping with what is happening in most European countries and the USA, where the tendency is more and more to use the commercial banks as the best channel for helping small businesses, and also it would prevent a large bureaucracy growing up. It would also, of course, make a lot of practical sense. A major problem with small businesses is actually making contact with them, and the clearing banks with their 12,000 branches are undoubtedly in the best position to do so.

Finally, the English Industrial Development Bank should be given the right to go to the market to raise additional funds for investment. This would be in line with what special credit institutions in other countries are allowed to do, and would enable it to plan its own affairs most sensibly. However, as a government institution it should be able to borrow with a government guarantee, as this would enable it to borrow long-term funds at the cheapest rates.

Three major tasks should be given the English Industrial Development Bank.

tasks for the bank

Firstly, there is an urgent need for a rediscounting scheme for channelling funds to industry. Banks cannot commit unlimited resources on a term basis to industry. They have to be limited by the short-term nature of their liabilities, and also increases in the average term of their lending means that they have to maintain a higher degree of liquidity to protect themselves against fluctuations in their deposit base. This in turn means that they are more likely to find themselves hit by inflation. This problem, as the Wilson Committee suggested, could be dealt with by a rediscounting facility, as we have seen the French doing. The clearing banks would be responsible, as they are at the moment, for assessing the credit-worthiness of the company seeking the funds, but the English Industrial Development Bank would guarantee the liquidity of these loans, thus enabling more loans and ones for longer periods to be given than prudent banking rules about liquidity would now allow.

The second task which the English Industrial Development Bank could be given is that of subsidising the cost of capital where it is felt that this should be done in the national interest. Interest relief grants are already available under the Industry Act 1972, but these arguably go to exactly the wrong companies. Instead of being used to help new industries or companies growing rapidly, they are used to prop up companies in structural decline. There is a need to openly recognise the two-tier interest rate system which exists, and then to start to use it to restructure industry. The cost of such a subsidy would not be great compared with the benefits that might flow from it. As Peter Readman has pointed out *Beating Britain's Handicap*, Guardian, 14 June 1976) a subsidy of £500 million over 5 years would enable £1,000 million of 5 year medium terms loans to be made available to industry at a rate 10 per cent below the current rate. The government in 1976 levied tax at 45 per cent on each £1 of value added created. If the interest

rate subsidy was restricted to companies which produced £1 of value added for £1 of investment, the government would achieve a 45 per cent return on its investment. This would be a much better use of oil revenues than spending them on consumer imports and unemployment benefits, and it would help to redress the tax bias against industrial investment.

The third task which the English Industrial Development Bank should be given is that of providing equity to small businesses. There is a clear deficiency in the availability of equity finance for small businesses, both as regards initial capital for start-ups and development capital to finance the expansion of established enterprises. This gap is now being filled in other parts of the United Kingdom by the development agencies, and should now be filled in England.

criteria for investment

Three ways of aiding industry have been suggested above. In carrying out all of them it is essential that the English Industrial Development Bank follows precise criteria for its investments. It is fundamental to the argument of this pamphlet that industrial aid should be used not to subsidise inefficient companies but to restructure industry. Therefore, aid should only be given to companies that fulfil a number of clear criteria. Firstly, aid should be given only to companies which are achieving acceptable levels of productivity. Secondly, aid should be given to industries which have a high added-value content. Thirdly, there should be a bias towards exportable projects. And, fourthly, there should be a bias towards products which are likely to be income elastic, that is, when their incomes rise, people buy more of them.

A second reason for insisting that the English Industrial Development Bank should adopt a tough system of credit assessment is that the introduction of a rediscounting scheme for channelling funds to industry could be used as a means of helping to change the techniques of credit assessment currently

used by the banks. The techniques of credit assessment used by the French banks have been influenced by the "mobilisable" credit procedures of the *Crédit National*, and the English Industrial Development Bank should also seek to encourage the English banks to adopt a closer and better informed relationship with their corporate customers.

It is not at this stage being suggested that the English Industrial Development Bank should be given the factory building responsibilities of the English Industrial Estates Corporation, and the environmental improvement powers which are currently exercised by local authorities, or the same responsibility for urban renewal that the Scottish Development Agency possesses. As has been seen in the case of the NEB, it is not always wise to load an organisation with too many responsibilities, and if the English Industrial Development Bank is to concentrate on its primary task of improving the performance of companies and stimulating their investment programmes, then it needs not to be burdened by other responsibilities. There is probably a case, however, at a regional level for making arrangements so that its work is co-ordinated with other bodies, both private and public, at that level. It would also make sense in due course for the English Industrial Development Bank to take over the work of COSIRA. The reason for suggesting that the handover of COSIRA should not be done precipitously is that COSIRA clearly works extremely well at the moment, and it would be foolish to disturb that work while the English Industrial Development Bank was seeking to establish itself as a useful and viable organisation. In the meantime COSIRA should be given additional finance and the ability to make equity investments. There might also be a case for the English Industrial Development Bank taking over some of the responsibilities which the Department of Industry now exercises in the regions through its regional industrial development boards. While it is not being suggested that the English Industrial Development Bank should be given all the responsibilities and powers that the Scottish and Welsh Development

Agencies have, it would clearly be necessary for the Scottish, Welsh and Northern Ireland Development Agencies to be given the same powers as are being proposed for the English Industrial Development Bank.

fiscal changes

The organisational changes which have been proposed should also be combined with a number of fiscal measures aimed at altering the unfavourable tax treatment of industrial investment. Here again, however, the aim should be to create as many decision-making points as possible, and to work as far as possible through the market, rather than seeking to concentrate decisions about investment in a few hands.

Three areas stand out where the government could take action to improve the tax treatment of industrial investment. Firstly, a future Labour Government should give very serious attention to the Wilson Committee proposal that a new type of institution, the Small Firm Investment Company (SFIC) be created. As the Wilson Committee pointed out, in the past businessmen and individuals with some capital used often to make investments in local businesses which they knew, or in the businesses of relatives. But the wider ownership of lower levels of wealth has naturally led to a greater aversion to risk and a greater desire for liquidity. It is also probably true that in the past where a particular industry was concentrated in a particular area, the local bank managers came to know that industry very well, and accordingly took a more entrepreneurial view. But such expertise is not, of course, likely to grow up spontaneously in the case of companies involved in telemetry or making process control equipment.

The best way of dealing with the problems of risk and illiquidity, and of providing the necessary expertise, is some kind of intermediation. But such vehicles for investment are likely to need some fiscal incentives to overcome the regulations that are otherwise likely to restrict them. For example, the Stock Exchange's

listing requirements for Investment Trusts lay down that not more than 10 per cent of a Trust's assets may be invested in one company, that not more than 15 per cent in total may be invested in unlisted securities and, in the case of listed companies, in holdings where the Trust's interest exceeds 20 per cent of the company's equity capital. The Wilson Committee, therefore, put forward the idea of the SFIC which would be an investment company which invested in unlisted companies, and proposed that there should be a specific relief of personal tax for the purchase of SFIC shares.

The Wilson Committee also gave some thought as to how an SFIC might operate. "An SFIC might desirably have a regional or industrial specialisation. This should not be a requirement, but detailed local knowledge or the acquisition of relevant industrial expertise would both assist in keeping down the costs of building up and running the company, and promote fruitful continuing contact between the SFIC and the managements of the companies in which it held shares. An SFIC might also employ one or more suitably qualified industrial experts itself or retain industrial consultants to act on its behalf." As they pointed out, where "SFICs chose to pursue some degree of industrial specialisation, small companies could expect to benefit from access to industrial as well as financial expertise, and would therefore see greater advantage in allowing outsiders to share in the equity of their firms" (*Evidence on the Financy of Industry and Trade*). This point is probably very important. It may well be that one of the most significant reasons why small firms do not go to the banks and institutions to get funds for expansion is that they feel that the banks and institutions have no real understanding of how industry works. A future Labour Government should seek to help small businesses, and the creation of SFICs is one way of doing so.

Secondly, a future Labour Government should follow the advice of the Wilson Committee and do all it can to help the further development of an over-the-counter (OTC) market in this country for

the shares of small companies, so that it becomes as important as the one in the US. Many small companies have been inhibited from seeking a listing of their shares on the Stock Exchange in recent years because the cost and obligations of doing so have become prohibitive. At the same time a number of constraints have existed on the development of an OTC market outside the Stock Exchange, such as, for example, the lack of the privilege currently held by the Stock Exchange whereby jobbers can hold securities for up to two months without paying stamp duty. The lack of an OTC market for the shares of small businesses is obviously a hindrance to small businesses both in terms of the marketability of their shares and their ability to raise capital, and if a future Labour Government wants the financial markets to work better for small businesses it should look seriously at how it can promote the facilities of OTC markets.

Finally, there is the tax treatment of industrial debentures and unsecured loan stock with terms of around 20 years. From 1963 to 1972 companies raised 15 per cent of their total external funds by means of industrial debentures and such loan stocks, but since 1974 this market has virtually dried up. The Wilson Committee regarded the dormancy of the long-term fixed interest loan market as one of the major deficiencies of the financial system in Britain, and there is a clear need to try to bring it back to life. At the same time it should be noted that a major difference between the fiscal system in this country and others lies in the tax treatment of bond interest, with bond interest in many other countries being taxed at a preferential rate. There is a strong case for looking at the feasibility of tax exemptions on income from industrial fixed-interest securities if a future Labour Government wants to redress the tax advantage which various forms of investment have over industrial investment.

impact of proposals

It can be seen then that a number of mechanisms exist by which a future

Labour Government could seek to channel the funds from North Sea Oil into industrial investment. By themselves they would not achieve all that needs to be done, but combined with a better strategic capability in government, manpower policies aimed at eliminating the shortage of skilled labour, a more appropriate allocation of research funds, the introduction of legislation covering sensible proposals relating to industrial democracy, a tougher competition policy and macro-economics policies which gave industry greater stability, they could go a long way to reverse the de-industrialisation of the country.

It is important to realise that we have a small open economy, and that we have to compete in a world in which practically every government seeks to help its industry by working in partnership with it. There is thus no way that the government can stand aside and leave industry to its own fate. Equally, it should not seek to do industry's job for it. The only route forward is a partnership in which government plays a strategic role while leaving to management and trade unions the responsibility for the specific decisions involved in running a company. As Sir Leslie Murphy wrote: "It is a feature of the western world that governments of almost every major manufacturing country respond to public pressures to try to stimulate the pace and direction of industrial development. If we stand aside in this country and allow market forces alone to operate we shall be overtaken and displaced by those of our competitors who have learned the skills of forcing the pace of development and seizing market opportunity by reinforcing commercial drive with the impetus of public financial support" (*National Enterprise Board, 1978 Annual Report and Accounts*).

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government and industry : a new partnership

David Sainsbury argues that the restructuring of British industry should be the highest priority for a future Labour government. Technical innovation and change cannot be held back and if we wish to pursue socialist objectives both domestically and abroad, particularly in the third world, it can only be done from a basis of industrial growth rather than of decline.

The author argues that current problems are too complex and deep-seated to be amenable to simple and dramatic solutions. The Labour Party must face up to the problems created by structural change and the failure of industry to innovate and adapt. This pamphlet looks, therefore, at the factors making for industrial change and at three main areas where government intervention can and ought to be effective: the capacities of and training for the labour force, research and development and the supply of funds to industry. A substantial part of the pamphlet is directed to a discussion of funding and why our financial system is not good at stimulating change. The pamphlet also considers two recent attempts to improve the supply of funds: the NEB and planning agreements. The former, it is argued, has a good record in many areas and these should be built on; the latter have limited use as a general instrument to increase the efficiency of industry.

Finally, practical proposals are put forward for improving the flow of funds to industry which stress the importance of decentralised decision making.

fabian society

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