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AUTUMN ADDRESS

Britain Resurgent

return to a wealth creating economy

Lord Young of Graffham

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Introduction

IN 1950, DESPITE ALL THE STRAINS OF THE AFTERMATH OF A WORLD War, the British people enjoyed the seventh highest living standard of major developed nations. Just 30 years later we ranked 14th. There were few of us who did not think that we were doomed to fall further. Indeed in the early 'seventies Herman Kahn of the Hudson Institute forecast that by the mid-nineties Britain and Albania would have the two lowest standards of living in Europe, East and West.

The seeds of that economic decline can be traced back a long way – to the time when we enjoyed the highest living standards in the world in the mid 19th century – but it was after the Second World War that it became apparent just how far we had declined as an economic power.

The most obvious signs were slow growth and the loss of world markets. We had a rate of growth much lower than other industrialised countries, almost half that of the OECD as a whole. We continued to lose our share of world markets; our share of exports of manufactures from main industrial countries was 25% in 1950 but 9% by the late 70s.

Reasons for relative decline

Many excuses for this relative decline have been advanced. They include both a low level and an inefficient use of investment, low productivity growth combined with high wage growth, poor industrial relations combined with bad management, lack of technological innovation, inadequate training and education and excessive public spending. Even that list of failings can be extended.

Crucially it was reflected in a simple failure to compete in world markets, including our own. For how many decades after the War was steel allocated rather than marketed and sold? This failure to compete was not just on the basis of price, but also on quality, design, delivery and after-sales service. These were the outward manifestations of an economy that was failing to create wealth as efficiently as other countries.

Government policies

There was no reaction to these failings, no public outcry, no great campaign. Instead there was a widespread sense of complacency and a simple belief that it was the Government's job to sort out the economy.

The cause of that complacency rested on the past successes of the British economy cushioned by the boom in the world economy after the War. People became accustomed to steady increases in living standards and largely ignored the fact that they were becoming relatively poorer. That bred the complacency in individuals and in companies which blocked the changes needed in the British economy. Lord Nuffield then described Britain as "a nation in semi-retirement."

People also accepted the claim of economists that they could manage the economy through fiscal policies which would stimulate demand. Politicians would supplement this by a series of *ad hoc* policy interventions to control the workings of the economy.

This belief in the power of government had two main effects. First, it produced an attitude which laid both the responsibility and blame on government rather than individuals. Second, it gradually increased the role of the Government in the economy. The share of government spending in GDP rose from 35 per cent in 1950 to 43 per cent in the late 70s added to which the effect of government borrowing was to crowd out the private sector.

The Government tried to create faster growth but the only consistent element in their policies was change. Their desire to manage demand led to 'stop-go' policies and their desire to change the industrial structure led to intervention after intervention.

- Industries were nationalised and successive attempts were made to improve financial discipline and efficiency.
- Hire Purchase controls would come on and off, sometimes only months apart.
- Industry was encouraged to invest in capital equipment through grants and allowances.
- Industry was encouraged by incentives and directed by compulsion to locate in particular regions.
- Companies were given subsidies to remain in business or to develop particular technologies.

- Planning was attempted in the ill-fated National Plan in the 60s and the Industrial Strategy of the late 70s.

How did Industry respond? Take the example of the car industry. Immediately after the war when the Government wanted cars exported, a system of steel rationing was used to make sure that the car companies *did* export. The result was that cars designed pre-war for British roads were exported to markets with inadequate after-sales service, whilst at home customers would have to wait (often for up to seven years) for delivery of a new car which was allocated rather than sold. And that was the birth of British cars' reputation for poor reliability.

As if that were not enough the car industry was again chosen to play an important part when governments wanted to regulate consumer spending; the result was that the level of purchase tax and hire purchase controls were changed no fewer than 14 times during the 50s.

Industry was also important in regional policy and factories could not expand where they were but were sent where the politicians decided; the result was a decentralised car industry which did not know economies of scale. As George Turnbull said at the time, 'we knew we were building inefficiency into the industry'. The way that industry was treated was graphically described by Sir Michael Edwardes in 1977:

> 'Industry has been like an overloaded donkey, being driven up hill by someone who apparently dislikes the donkey intensely – and I speak of successive governments.'

It was only that poor donkey that could create the wealth that our country needed.

I wonder how many politicians spoke out during those three decades of the need for wealth creation? How many appreciated the disaster of low profits, and spoke of the need for real incentives? Few indeed. For the main belief was that governments should manage the economy and that their concern should be with the distribution of wealth more than its creation. Indeed I recall still the long years when the only respectable way to acquire wealth was to win the football pools. Then one day came the time when being a pop star was also acceptable. It was not much, but it did mark the beginnings of respect for individual effort.

Keith Joseph was a notable exception. He spent much of the 'seventies going around the colleges and schools with a simple speech – that what this nation required was more millionaires. It is today difficult to recall the sense of shock, if not ridicule, that this aroused but it struck a chord and before long it was being echoed back. At long last there was a politician putting emphasis on the need for individual responsibility and enterprise as well as the importance of incentives. Indeed that was how I came to work for him.

Way back to wealth creation

By the late 70s it was clear that governments had lost their way. Clear that the capacity of the economy to generate wealth for our people had declined badly.

1979 saw the return of a Government whose central philosophy was wealth creation. A Government whose central belief was that the key to wealth creation lay in individuals working efficiently in competitive markets.

The restoration of an economy and a culture which welcome wealth creation has been, and continues to be, a massive task. It encompasses a whole range of policies; indeed, it is crucial that the need to encourage wealth creation infuses all our policies.

Three elements

The reversal of the long years of post war decline needed three elements – the encouragement of individual initiative, the spur of competitive markets and the efficiency of our industries.

Individuals

The skills, ability and initiative of individuals are the key to creating wealth. Too often in the past, we concentrated on large companies and institutions without considering the enterprise of the very people who make up these institutions. Enterprise is as crucial to the success of large companies as it is to the birth of new businesses.

The ability of individuals to use their initiative, skills, and enterprise does not exist in a vacuum. It can be harnessed only in the right conditions, which simply did not exist in the 60s and the 70s. I would identify four conditions as vital to individual enterprise – stability in decision taking, pro-enterprise attitudes, clear incentives and less bureaucracy.

First, *certainty and stability* provide a foundation of confidence upon which decisions can be taken. Risktaking is at the heart of enterprise, but risks that can be calculated and these need stable foundations. Low inflation is essential because it gives people more confidence in their planning and their decisions. That applies to those running businesses as well as to those who invest in them. The consistency with which this Government has pursued the objective of low inflation plays a vital part in stimulating enterprise.

Second, *pro-enterprise attitudes*. There has been a well documented anti-enterprise streak in British attitudes for decades. It is based on many different elements in our national makeup, and has been a strong and pervasive influence which has channelled the talents of our young away from business. Young people were not exposed to the excitement or challenge of running a business. Parallel to these attitudes was a distaste for the practical and the technical which pervaded our educational system to the detriment of technical innovation and vocational skills. In some cases education has even come to reject such notions as excellence or standards or competition.

It was not one-sided; for just as destructive was the gulf which appeared between industry and education. Education was seen as a separate part of our society unrelated to the world of commerce. The gap between the two simply encouraged mutual incomprehension and neither side made any attempt to repair the damage.

We now accept that if we do not motivate our best young people to use their talents in industry and commerce then our natural base for wealth creation is weakened. Many of the policy initiatives which we have put into place are aimed in tackling these problems. The rewards for policy initiatives such as mini enterprise in schools and the Technical and Vocational Education Initiative will come in the next century; but they are an important part in creating the enterprise culture.

Third, *incentives*. Incentives in the economy were weakened both by the high level of taxation and by its structure. The effect of a high level of personal taxation is obvious, for fewer of the rewards of initiative and hard work go to individuals. The effects of a complicated tax system are more insidious but equally destructive; for the system of tax which grew up had a complex structure of special reliefs and exemptions which gave tax loopholes. So people's decisions were distorted by the rules of a tax system. And the need to find a way round that tax system diverted their energies.

Our desire for a tax system with much lower tax rates and a simpler structure has motivated a number of the tax reforms which this Government has put into place. We have already substantially reduced personal income tax, and simplified business taxation.

In one respect, individuals who ran companies were offered a clear incentive in the post war years, but the incentive was to employ capital not labour. We had a tax system which subsidised investment in capital goods and taxed the employment of labour. So people were replaced with machines not because that was a natural economic decision but because the taxation system distorted the choice. The reform of company taxation in 1984 combined with the removal of the National Insurance Surcharge has gone a long way to redressing that particular distortion.

Fourth, *less bureaucracy*. Regulations are necessary to limit the actions of individuals in the cause of consumer protection or off health and safety. But sometimes such regulations were

imposed in ways which suited the bureaucrat rather than the businessman. Sometimes they became out of date but remained in force. And sometimes the regulations were imposed unnecessarily. Such unnecessary bureaucracy took up the time of people in business and limited the time they could spend creating wealth. Some of the most obvious controls and regulations were swept away in 1979, including controls on pay and prices and exchange controls. But there has been a continued emphasis on tackling unnecessary regulations and excessive bureaucracy. That is inevitably a long, hard and detailed process and it will continue.

Spur of competition

Wealth creation requires more than the encouragement of individuals, it also needs the spur of competition. Competition offers both rewards and penalties. It seeks out those who produce the goods and services which give the consumer best value for price and quality. It provides the spur to improved performance and efficiency from industry and commerce. Competitive markets provide the best environment in which individuals can create wealth efficiently.

An open economy provides such competition. The need to beat fair competition puts pressure on British firms to restrain costs and prices and to improve quality. The experience of foreign competition has often encouraged British industry to more efficient production methods, higher standards of design and quicker responsiveness to changing industrial and consumer needs. Indeed our manufacturers meet international competition on every high street in the land.

There are more challenges ahead. By 1992 we will have a single market for all in the European Community, free of many of the significant barriers which still impede trade and competition today. A challenge for all at home but an opportunity abroad.

Healthy competition within our economy has long been accepted as a key ingredient of an efficient economy, and the Government is committed to a strong competition policy. Since last year, some aspects of competition policy have been under review. This review is continuing, but I can now announce some interim conclusions.

On mergers policy, I consider that the law should continue to give me discretion to refer mergers to the Monopolies and

Mergers Commission on public interest grounds. But the Review has also confirmed my view that in determining whether mergers should be referred, the main, though not exclusive, consideration should be their potential effect on competition. In an open economy like ours, this of course involves taking full account of international competition both from European and from other sources. I shall therefore maintain the policy that my predecessors consistently followed since July 1984 of taking reference decisions against this background. The policy has stood up well to the test of time. It ensures that the interests of other industries and of the final consumer are adequately protected; it makes for the greatest practicable degree of certainty; and it leaves to the market decisions on which the market will generally be a better arbiter than government. Government should, I believe, intervene only where the interests of the decision makers in the market are likely to diverge from the public interest.

There has, however, been widespread criticism of the procedures of statutory mergers control, which are time consuming and inflexible. Good progress has recently been made in cutting the length of MMC investigations; but work is continuing to see if further improvements are possible, including legislative change if necessary.

I am also considering possible improvements in the special provisions of the Fair Trading Act for the control of newspaper mergers. After discussions with me the MMC have said that they will generally complete future enquiries into newspaper mergers within two months, rather than the three months which the law gives them. This improvement will make it more difficult for the parties to newspaper mergers to argue that an MMC enquiry is ruled out by financial urgency.

The accounting treatment of mergers and acquisitions has been a topic of public debate. It has been argued, for example, that current accounting rules do not result in adequate disclosure of the true financial implications of mergers. With my encouragement the Accounting Standards Committee is reviewing the relevant accounting standards, and I look forward to seeing the results of this work shortly.

On restrictive trade practices, the work of the review – and the evidence submitted by interested parties – has confirmed that there are fundamental weaknesses in the existing legislation, and thorough-going reform seems likely to be necessary. The review

will work up specific proposals for fresh legislation in this area, and I expect to publish a consultative document next year.

Our belief in the spur of competition has extended much wider than that.

Since 1979 we have privatised more than one-third of what had become the state sector of industry. There are many examples of privatised companies which have become more efficient, improved their market share, and involved their employees. The decisions which those companies now take are based on the needs and prospects of that company in competition with other national or international companies, rather than on the needs of the exchequer or the whim of a Minister. Cable and Wireless, the National Freight, Amersham International, Jaguar and many other examples show how valuable the process of privatisation has been in creating successful companies and wealth for this country.

Those companies which remain in the public sector have been given more stringent financial discipline. We have brought them closer to the forces of competition which they would experience in the market. The contrast for some industries could not be greater.

In 1979, when I first went to work in the Department of Industry, British Steel was making a loss of £1.8 billion. This year it has made a profit of more than £170 million. Even so the opportunities for such companies are more limited in the public sector and the reality of competition less intense. So wherever possible we will continue to privatise.

Those who remain in the public sector will be encouraged to act as they would in the private sector. It was a grave mistake in the past to run industries as social services. The inefficiencies created through social industrial policies lost jobs and wealth rather than creating them.

The era of corporatism infected labour relations as much as it did production methods. Successive Acts gave monopoly powers to unions in their bargaining with employers. The need to free the labour market and to return decisions to union members instead of union bosses has been an important part of our industrial relations legislation. The spur of competition is just as important in the labour market as it is in the product market. Indeed it was Eddie Shah who, just by threatening to bring modern practices to Fleet Street, provided the first dash of reality. Today the flourishing state of the newspaper industry and the silence of Fleet Street itself bear equal testimony to the effectiveness of the spur of competition which was missing for so many decades.

Efficiency

So far I have set out the main elements in our strategy to encourage individuals working in competitive markets. Is that sufficient for us to achieve a wealth creating, world beating economy? Some people have said that we need much more than that. They believe that we need an 'industrial strategy'.

As so often in British life this is where semantics seems to prevent understanding. I reject the idea of an industrial strategy because of what that language implies. It implies that we, the Government, have some special insight into which industries should be developed and having chosen them some special insight as to how they should be developed. This is nothing else than picking winners, and a return to the failed policies of the 60s and the 70s.

Some, who accept the difficulties inherent in picking winners, propose a variant on an industrial strategy by suggesting that we create a series of Development Agencies. Here a collection of Ministers and civil servants, or their deputies, make strategic decisions about regional investments. Much is sometimes made of the role of the private sector within such an Agency – but the risk is essentially public and that is where the proposal is flawed.

But I do believe that we need a strategic vision, if not a strategy, about the way back to a wealth creating economy. I have already outlined two critical parts of that strategic vision; namely the encouragement of individuals and of competitive markets. I believe that there is a third element and that is the encouragement of efficiency.

Competitive markets will fail to create wealth efficiently if there is a lack of information available to individuals and to firms, or if there are essential activities which individuals or firms believe that they cannot afford. We should encourage Management education and innovation if we wish to encourage wealth creating activities. The essence of our policies in such areas must be to identify where these obstacles to competitive markets exist, remedy them and thus help individuals to create wealth.

Our task is to work with companies as *they* work towards the best solution for their own individual problems. And our emphasis should be on encouraging them to work with private sector providers of the services and information which they need. We will seek to move people away from government grants which are given for assistance in particular industries or for particular activities, and to move towards letting industry itself identify the problems, usually with the assistance of private sector consultants.

There may well be cases where an element of public sector financial assistance is necessary, for example in helping to sponsor the application of some new technological innovation which has considerable learning costs attached to its adoption. Our involvement in management education may need to be much closer in helping to set the structure of qualifications, and encourage the development of courses which will have widespread application through British industry. I am much encouraged by the start which the Council of Management Education and Development under Bob Reid have made.

The emphasis of our approach in industrial policy is not towards identifying priority sectors of industry and it should not be towards giving unconditional grants. We need to move towards filling information gaps at a local level, encouraging the application of new technologies across industries and developing excellence in our nation's managers and employees.

Conclusion

The post war decline in the British economy's ability to create wealth has now been reversed by the policies adopted since 1979. We had learnt the lesson that intervention by previous Governments prevented wealth creation more than encouraged it. We have put our belief in encouraging individuals to work effectively in competitive markets. Above all else, there are signs that we are no longer convinced by a belief in our inevitable decline and many, particularly amongst the young, believe that we are on our way back again.

Our approach is to set the climate for enterprise within which individuals and companies will create wealth without direct government intervention. We reject the vision of an industrial strategy because its effect would be to take the responsibility away from the 55 million people living in Britain – where it rightly belongs – and to put that responsibility on government; a responsibility which government has never been able to deliver.

But we do have a strategic vision about the best way in which to encourage wealth creation. That strategic vision encompasses a very wide range of policies ranging from education to technology and from taxation to world trade. We recognise that government does have a role to play in working with industry to encourage the taking of efficient decisions. But working with industry does not mean that government should identify what firms should do or making financial support the main policy instrument. It means enabling companies to take their own decisions with the best information and advice which can be made available to them. And it means concentrating on the excellence and skills of our managers and our employees.

Our policies since 1979 have set us firmly on the road towards a wealth creating economy, for we now realise that without creating the wealth first we cannot invest in the kind of society that we all wish to see. Today we have a clear vision of the way in which government can create a climate and a culture which encourages wealth creation. We will continue to strengthen the policies to achieve that vision.

I am confident that the enterprise of our nation will flourish and create the wealth to meet the needs of our people. The lessons of the past few decades have not been lost.