

Holloway, Ronald G.

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Pleading for EEC-Membership

by Ronald G. Holloway, Toronto

The crucial problem of the British economy has been its failure to adequately increase output per man-hour in manufacturing industry. In the period 1959–69 the United Kingdom improved this figure by 46 p.c. whereas West Germany improved it by 76 p.c., France by 80 p.c., Italy by 108 p.c. and Japan by 162 p.c.

Although the average British worker is supported by an exceptionally small amount of capital compared with workers in other industrialised countries¹ it is in the utilisation of manufacturing plant that international comparisons become strikingly adverse to Britain². Restrictive practices and resistance to more extensive shift-working deprive the British economy of many potential cost advantages associated with modern machinery.

Variation of Natural Resource Endowments

International comparisons have also been made of aggregate productivity levels and, allowing for differences between exchange rates and real purchasing power, the level of productivity in the United Kingdom has been found to be only 54 p.c. of that in the United States while also falling behind a number of other countries³. These differences are only to a very small extent due to geographical location and climate. Much more important is the significant variation in natural resource endowments. Another major factor is the scale of the local market, though this is increasingly an institutional rather than a geopolitical factor—national frontiers are becoming economically less important than free trade area conventions and common market treaties. Institutional factors and attitudes are of increasingly major importance in determining differences in levels of real productivity; and Britain is unfortunate in that its early industrial leadership

developed both institutions which are now anachronistic and economic attitudes which are complacent. This early leadership was also associated with decisions to continue to rely on a relatively uneducated, unskilled and low-paid labour force in a series of industries destined, over the long term, to fail in carrying on the impetus of national economic growth, particularly in major export markets.

These factors do not, however, fully account for the differences in the rates of productivity growth which have frequently been observed. More important than the statistics (which, in any case, are subject to imperfections) are the factors which lie behind them. In addition to those already indicated, these include differences in investment ratios; population and labour force growth; labour flexibility; discrimination on the grounds of race, social origin, age and sex; structural change; and comparative levels of technological research and development.

Inadequate Investments

Much play has been made with international comparisons of investment ratios in which Britain scores badly. Such comparisons are, however, falling into disrepute. This is partly because most of these comparisons have been made on an aggregate instead of a per capita basis which means that the extent of investment merely to provide homes, schools, hospitals and jobs for a larger population is ignored. The figures used invariably relate to gross (or net) fixed capital formation (or “productive” fixed capital formation); and so by definition, exclude the greater part of expenditure on maintaining and improving health, knowledge and skill. This ignores the fact that these are productive assets which are even more essential than such recognised items of producer's capital as plant and machinery.

A further conclusion which may be drawn relates to the international comparison of incremental capital-output ratios (ICORs) obtained by dividing the share of fixed capital formation in

¹ E. F. Denison, *Economic Growth*, in: *Britain's Economic Prospects*, Brookings Institution, 1968, p. 272.

² *The Role of Technology in Productivity*, National Productivity Conference 1967, para 11.

³ A. Maddison, *Comparative Productivity Levels in the Developed Countries*, in: *Banca Nazionale del Lavoro Quarterly Review*, December 1967, p. 302.

national product by the rate of growth of national product (or of national product per person). These comparisons are frequently made, with the United Kingdom again coming at or near the bottom of the growth league tables. As a basis for classifying countries in terms of the efficiency or productivity of their investment, ICORs are a source of confusion, while they are not much use for estimating investment requirements if they are not invariant to the rate of growth itself⁴.

One reason why ICORs are a source of confusion in classifying countries in terms of the efficiency or productivity of their investments is that they generally take no account of differences in the total capital stock and the amount which needs to be expended merely to maintain it. Adjustments to allow for this have sometimes been made but their precision is highly doubtful.

Even if accurate international comparisons of net capital formation were made, differences in the composition of investment mean that some assets last longer than others and these assets probably show smaller returns over the relatively short period for which reliable comparative statistics are available. Again, investment in directly-productive capital (most investment in private industry for example) will tend to have a shorter pay-back period than investment in social overhead capital such as roads and schools. Further, directly-productive capital has a directly measurable return. Social overhead capital has not.

Weak Population Growth

The efficiency of capital is determined by the state of demand and by technological, managerial and labour efficiency, economies of scale and related structural change. In view of the importance of these parameters, it seems that the rate of growth is not strongly influenced by the volume of fixed capital formation⁵. In other words, growth is not fast because such investment is high; investment is high because the opportunities for growth are good. Nevertheless, we may conclude that investment in the UK has been inadequate. Indeed, if international comparisons are used to show that the rate of return on investment in Britain has been low, the conclusion must be that relatively more investment must be carried out in order to achieve a satisfactory rate of growth in the future and the efficiency of investment must be improved.

⁴ T. P. Hill, Growth and Investment according to International Comparisons, in: *The Economic Journal*, June 1964.

⁵ O. Aukrust, Investment and Economic Growth, in: *Productivity Measurement Review*, No. 16, p. 49.

One of the factors which have affected the rate of growth of productivity in Britain appears to have been the comparative lack of growth in population and, more especially, the comparative lack of growth in the working population. A rapid increase in the labour force gives some advantages in raising productivity since it stimulates investment and increases flexibility. When the labour force is stationary improvements tend to proceed on a piece-meal basis, continually hampered by the existence of older capacity. If, with a virtually static working population, Britain had devoted as much investment to modernising its equipment as those countries with expanding populations had to devote to widening their capital structure, a significant advantage in increasing productivity would have been gained. The point is, however, that British industry has not felt an urgent enough incentive to carry out this investment in greater efficiency, and the whole economy has consequently been more sluggish and less responsive to change⁶.

Largely as a consequence of its very slow rate of growth, the United Kingdom labour force has enjoyed a greater degree of full employment since the war than those of most other industrial countries. In the context of the other factors which have been present, this situation has not been consistent with the objective of a high rate of economic growth. Resulting in insufficient labour flexibility, it has led to the deferment of investment programmes and to the under-utilisation of capacity when investment has taken place. This lack of flexibility has been largely evident in the marked tendency to hoard labour but it has also had serious effects in reducing the stimulus to workers to acquire new and higher skills and in reducing the ability of new firms to attract workers for training. High inter-industry, inter-status, and inter-occupational mobility of the labour force is a characteristic of modern economic growth⁷. Geographic mobility is also a requirement which, in Britain, has been impeded by local public housing control.

Lack of Flexibility

Under full employment, the rigours of competition are reduced and it is possible for high-cost firms to continue to operate; whereas in more competitive conditions they would normally be driven out to the advantage of the average level of productivity. It is, however, noticeable that when deflationary measures have been taken, the inefficiencies of British industry have, if anything, been usually greater since much of the

⁶ PEP, Growth in the British Economy, 1960, p. 4.

⁷ S. Kuznets, *Modern Economic Growth*, Yale University Press, 1966, p. 494.

mentality of the full employment years has previously endured. A fundamental change now appears to be taking place.

While greater determination in scrapping old plant and machinery and an improved emphasis on capital-deepening will enable Britain to overcome the disadvantage of the lack of flexibility that a static labour force combined with full employment policies has prolonged, the British need to make improvements in the more direct use of human resources. Britain has lagged behind other countries (especially Switzerland, the United States, and Sweden) in relating the educational system more closely to technological needs and in developing specific vocational training. There is also a relatively acute problem in the need to abandon unjustified discrimination based on race, social origin, age and sex. The Labour Government permitted a large influx of coloured workers from the Commonwealth and employers have generally welcomed them as a low-paid labour force. Private employers, however, have not recognised that some of these workers have fairly high educational and vocational qualifications; and, outside the public service, it has often proved very difficult for Asian and African graduates to obtain professional or managerial employment.

Despite the 1944 Education Act and other developments, Britain is still a relatively class-ridden society where birth remains a determinant of status. British industry has also tended to perpetuate the cult of maturity, believing that the art of commerce lies not in knowing but in doing. Britain has lagged behind the United States and some other countries both in establishing business schools and in appointing their graduates to responsible positions at an early age. Even more important, because it is present on a larger scale, is the attitude of many private sector organisations to the employment of women in a senior capacity. British women are a potential source of professional, managerial and ad-

ministrative talent which has scarcely been tapped⁸. Here Britain has a great deal to learn from the Scandinavians.

Shifts in Industrial Structure

Modern economic growth is characterised by rapid shifts in the industrial structure and it has been argued that Britain suffers from premature industrial maturity⁹. Britain, unlike many of its principal competitors, has not benefited much in recent years from the movement of labour from rural activities to secondary industry, and cannot expect to do so in the future. Productivity in the agricultural sector is still only about 75 p.c. of that in the rest of the economy; but the scope for a major rural contribution to national productivity improvement is severely limited, partly because the agricultural, forestry and fishing work force is now only about 2 p.c. of the total working population of the country, and partly because technological changes required are now mostly small and gradual, depending increasingly on the awareness of the need for more modern techniques of farm management.

Britain's farmers are already highly efficient by international standards. Over the period 1955–56 to 1965, the ratio of output per worker in British agriculture to output per worker in the rest of the economy improved by 40 p.c.—more than in any other OECD country except Italy and, possibly, Japan. But a comparison over more recent years is not so favourable and, indeed, improvements in British agriculture cannot be expected to keep pace with the often spectacular changes which are taking place in some European countries (and in Japan) which, in some cases, mean the sudden and widespread abandonment of centuries-old methods and the mass exodus of the rural underemployed to the towns.

⁸ National Labour Women's Advisory Committee, *Discrimination Against Women*, 1968.

⁹ N. Kaldor, *Causes of the Slow Rate of Economic Growth of the United Kingdom*, Cambridge University Press, 1966.



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The arguments which are deployed regarding Britain's premature maturity usually ignore the fact that there is a growing tendency in high-income countries to a shift of the labour force into the tertiary industries where productivity changes are, for the most part, immeasurable. This is because many services are provided by Government and local authorities without any benefit-related charge to the individual or community and have therefore to be valued at cost while professional and other private services often show a considerable lag in increasing fees and other charges so that these fall behind their true market value.

Switch to Services

This switch to services is evident in the economies of the United States, Sweden, Canada, the United Kingdom and other industrialised countries; and it is to be welcomed. It may be concluded that the United States has a relatively more important service sector, especially if transport and storage are excluded, partly because consumer preferences shift in favour of autonomous services (e.g. tourist travel and entertainment) as income rises, and partly because of greater opportunities for the economies of scale of specialisation through the development of ancillary services (e.g. management consultancy). In view of both the gains of specialisation and the greater external economies (benefits not charged in price) generally obtained from these ancillary functions, this structural change will tend to increase total net value added rather more than it would otherwise increase, despite the fact that labour productivity will tend to be less in these services than in the more capital-intensive manufacturing industries.

Some improvements in productivity have also been associated with rationalisation and mergers. Amongst European countries, however, British companies are already relatively large and the scope for further productivity improvements from this source is correspondingly limited. Some acceleration can be anticipated, however, from the activities of the Industrial Reorganisation Corporation.

Productivity growth is to a large extent a function of technological change. There are two manpower aspects to technological change. Firstly, the quantity of labour input per unit of output usually falls. This decline in the quantity of labour input is a basic mechanism in the process of economic growth. A fast rate of technological change need not lead to net labour displacement, however, if demand increased rapidly. Technological change is not only permissive of economic growth in setting resources free for expansion. It also tends to stimulate growth by creating new demands. Secondly, technological change usually involves a change in the quality of the required labour input.

Research and Development

Britain is the technological leader of Europe and some of the relative advantage in productivity growth which other European countries hold may be due to their ability to close the gap by importing its advanced technology as well as that of the Americans. Part of Britain's relative failure in productivity growth is undoubtedly due to its success in establishing subsidiaries on the Continent and in selling its technology under licensing agreements. Britain is spending much the same proportion of its GNP on civilian research and development as the Americans but, while the British excel in research, they tend to lag considerably in commercial development.

It seems clear that technological change contributes more to growth if the economy is prepared to receive it than if innovation takes the shape of a series of surprises. It is therefore important to try to anticipate the scope and nature of technological change and its impact in terms of employment levels and skill requirements. In view of the lead of Britain's technological industries over those of other European countries, it is clear that the best hope of improving Britain's slow rate of productivity growth is to gain better access to large markets through British entry into the European Common Market. Fortunately, this hope is realistic.

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