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TAKEOVERS AND INDUSTRIAL POLICY: A DEFENCE

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INQUIRY INTO CORPORATE TAKEOVERS IN THE UNITED KINGDOM

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FOREWORD

The David Hume Institute was commissioned by the Joseph Rowntree Foundation to conduct an Inquiry into the issues raised by Corporate Takeovers in the UK. The Final Report of the Inquiry took the form of a joint monograph written by Sir Alan Peacock, Chairman of the Inquiry and Graham Bannock, its Research Director. It was published in June of last year and excited considerable press comment.

A Colloquium sponsored by the Institute in association with the Bank of Scotland and the Joseph Rowntree Foundation was held in Edinburgh on 22nd November 1991 at which the Final Report, **Corporate Takeovers and the Public Interest**, was taken as the point of departure for an extended discussion of the issues raised by it. A list of the members of the Steering Committee of the Inquiry is given on the front inside cover and another list of those who attended the Colloquium is given in an Appendix to this Paper.

The Colloquium was governed by 'Chatham House Rules' which precludes the identification of the views of any individual members in any published account. However, Graham Bannock and Alan Peacock agreed to prepare an impressionistic account of the discussion and their reactions to it. Just after the Colloquium, the Trade and Industry Committee of the House of Commons published its first report on Takeovers and Mergers, and it seemed sensible to compare its findings with those of the Joseph Rowntree Inquiry. The authors have therefore followed up their account of the Colloquium with a critique of this Report, and have added, for good measure, some observations on the House of Lords Report on Innovations in Manufacturing Industry published in January 1991. The House of Lords Report does not deal directly with the issues raised by takeovers and mergers but its recommendations regarding industrial policy run counter to the authors' ideas of the right approach of government towards competition policy of which takeover and mergers policy forms an important part.

It will not surprise the reader that Bannock and Peacock defend their Report with characteristic vigour, but their views are their own. The Institute has no collective views on any public policy question and is in no way committed to the views of the authors.

Finally, the Institute would like to thank both the Bank of Scotland for the support in running the Colloquium and the Joseph Rowntree Foundation for its support of the Inquiry itself and the follow-up.

Hector L. MacQueen Acting Director.
January 1992

1 INTRODUCTION

The Colloquium held by the Institute on 22 November 1991 took as its starting point, as already explained, the Report that we prepared for the Joseph Rowntree Foundation on Corporate Takeovers and the Public Interest. The terms of reference of the Rowntree Inquiry required the Committee set up by the Foundation to review the evidence of takeover activities and its likely results, to examine the mechanisms governing takeover activity, and to assess the consequences of takeovers, prior to presenting policy recommendations.

It may be helpful to remind the reader of the main findings presented in the Report. We reviewed the evidence, including that provided in the research reports written for the Inquiry, and found none that supported the view that takeovers succeed in improving the performance of the companies involved or of the national economy. Nor did we find convincing evidence that the threat of takeover is always a spur to managerial efficiency. We also found no evidence to substantiate the view that takeovers were a major cause of regional disparities in income and employment.

It was the policy conclusions of the Report which were the main subject of discussion at the Colloquium. We concluded that there are imperfections in the market for corporate control and that, while not always a bad thing, large takeovers (and especially hostile bids) were a symptom of a deeper problem. This problem is that the energies of businessmen are being diverted from building businesses by product innovation and internal expansion and into the pursuit of short-term profitability. The greater prevalence of takeovers in Britain (and the United States) than in the more successful economies of Japan and Germany helped to put the issues into perspective. In these countries and others, ownership and control of the largest enterprises seems to be less clearly separated than in Britain, while owner-managed businesses play a larger role in their economies.

The Report was sceptical of the usefulness of tighter controls on mergers as such, although it did recommend a number of measures to remove tax and other biases in favour of mergers, and also the use of a broader concept of competition in selecting references to the Monopolies and Mergers Commission. The main thrust of the Report's recommendations was directed at increasing the relative importance of owner-management, the proactive nature of shareholder involvement

in corporate control, a change in emphasis in competition policy towards reducing barriers to entry, and the promotion of innovation. We do not repeat the arguments in favour of such a policy here, but rather illustrate the complexity of the issues by summarising other aspects of the debate arising from our Report and presenting a critique of the results of recent official enquiries which both favour more intervention as a solution to the problems raised.

The present paper begins, then, by reviewing some of the issues discussed at the Colloquium. This first section is brief and does not attempt to give a full account of a long and controversial discussion. In the second section we review the recommendations of the House of Commons Trade and Industry Committee Report, *Takeovers and Mergers*, which was published a month after the Colloquium. A final section reviews the findings of the House of Lords Select Committee on Science and Technology, *Innovation in Manufacturing*, which appeared in January 1991.

The issues reviewed here are of great importance for the future prosperity of the United Kingdom. Whilst, as the second of the two official reports emphasises, the roots of the problems discussed are deeply embedded in the history and culture of the country, it seems to us that the widespread belief that their solution lies in more, rather than less intervention in economic affairs, is ill-founded. This is our theme; though, as we attempt to show, it does not rule out government action to remove obstacles to the workings of markets. Nor are we despondent about the ultimate prospect of success in solving these problems - though there are no quick solutions.

2 THE COLLOQUIUM

All speakers supported the conclusion of the David Hume Inquiry Report (henceforth 'the Report') that takeovers were, in the British context, at best a mixed blessing. The temptations for managers to embark upon empire-building by acquisition, the ease with which companies could be acquired on the (London) International Stock Exchange in contrast to Continental exchanges, the short-term benefits to financial institutions from takeovers, the remaining biases in favour of acquisitions in tax, accounting and other regulations, all received attention. Regret was expressed about the loss of regional headquarter companies.

However, it was also recognised that the threat of takeover had prompted over-diversified and unwieldy companies to divest subsidiaries to the benefit of shareholders. Actual takeovers had in some cases led to improved management and performance. One speaker pointed out that the difficulties of integrating merged companies were generally underestimated, the process of amalgamation could take years, and the whole legal and regulatory background was open to the criticism that it undesirably forced the pace. Companies that regularly acquired others did gain valuable experience which enabled them to minimise the difficulties: this might partly explain the relative success of conglomerates such as BTR and Hanson.

Another speaker pointed out that there was no reason to expect that the record of businessmen's success in takeovers would be better than that of other decisions they took: 50 per cent were wrong. Another attributed the poor record of mergers in adding value for shareholders to an inability to see that success ultimately could only reflect the performance of individual operating businesses and not in vague concepts of scale, scope and synergy. This was illustrated by the fact that Honda, concerned with the former and now an international automotive success, had only produced its first car in 1967 - the year that British Leyland, concerned with the latter, acquired the Rover company.

Despite these qualifications about the value of mergers, very few speakers wanted more stringent restrictions on takeovers, and none argued for a total ban on hostile bids. The exceptions to this came from those who were concerned about regional consequences, though there was little convincing evidence that, for example, Scottish headquarter companies could be effectively preserved in the long run by takeover

legislation. The concern here was not so much that takeovers would be followed by rundown and closure - there had been little evidence of this - but that the regional economy would suffer by loss of subcontracting and other consequences of a loss of local senior decision-takers.

Some speakers did want to see broader issues, including regional ones, being taken into account from the outset in selecting takeover bids for referral, but others argued that this would create confusion and promote the further politicisation of merger control. (The contention of the Report was only that the concept of competition affecting referral should be widened beyond market dominance and pricing.) Once a referral has been made, the MMC has ample scope to consider any matters affecting the public interest.

The Takeover Panel did attract criticism on the grounds that a large proportion of its members have a vested interest in the volume of takeovers (only two out of 17 were industrialists, and none could be said to represent consumers). However, the Panel received a spirited defence for its role in ensuring fair treatment for shareholders. The frequency of takeovers did not reflect a regulatory bias but rather the distinctive nature of UK capital markets, which emphasised equity, equity yields and the openness of our corporate culture.

The emerging EC merger regulation procedures under the 1989 Act were, in their emphasis on competition, modelled on the British system. The permissiveness of European culture towards obstacles to takeovers by potential victims were deeply rooted and unlikely to be changed by the EC draft XIII Company Law Directive. This directive, which is unlikely to be enacted soon, says nothing about the price at which shares may change hands in a bid situation, nor does it outlaw poison pills or other protective measures banned by the Takeover Code.

There was a fair measure of agreement with the Report's analysis that the takeover issue is deeply embedded in the wider issue of corporate ownership and control. To accept this was not to impute blame to any individuals either on the side of management or among the shareholders: there was a need for a change in culture that would allow shareholders to exercise their rights to influence management.

The majority of participants seemed to be against the mandatory adoption of a two-tier board system, and indeed against any radical reform involving major legislation. However, it was recognised by one speaker that some changes to the law might be necessary to allow

institutional shareholders to become more closely informed about their companies without infringing the rules against insider trading. Another difficulty is that institutional shareholders do not have the resources to engage in a continuous dialogue with management. These need not be serious problems if non-executive directors were to play a larger role, which most participants felt was the solution: an extension of the role of professional auditors, which was an alternative, did not seem to be practicable. It was considered that the more widespread formal separation of the roles of chairmen and chief executives would improve corporate governance.

There were nonetheless difficulties in promoting the role of non-executive directors. Whilst institutional shareholders were already using their influence to this end, there was the problem of the gap between pension fund and other trustees and the investment managers to whom they conferred responsibility. One speaker suggested that a voluntary code of practice on corporate governance, in which one element would be the appointment of non-executive directors, would help to speed up change. Such a code could be given some teeth if it had to be borne in mind when assessing whether or not directors had properly discharged their legal responsibilities.

In general, it has to be reported that whilst the participants agreed with the analysis of the Report, there was little enthusiasm for the recommendations. One strand of criticism was that the recommendations would not be effective in promoting owner management, and that it was necessary to deal with institutions as they were. A second strand, difficult to separate from the first, was that the major recommendations for tax reform to remove discrimination between different forms of saving were not politically practicable. Generally the feeling seemed to be that the recommendations did not propose sufficient intervention to alter the situation though, as our brief account of the discussion shows, there was no consensus on alternative measures other than a general desire to promote the role of non-executive directors.

Comment

It is of course true that a major shift towards owner-management in large companies would not result from the implementation of our recommendations for the removal of tax distortions in the short, or even medium term. Such a shift would not in itself bring UK economic

structure and governance more into line with that of continental Europe or Japan, nor would it necessarily reduce the incidence of takeover activity. What the tax changes should do, in conjunction with a more dynamic concept of competition and the removal of barriers to entry, would be to promote the emergence of new substantial companies and a more competitive and innovative economy, in which takeover activity played a much smaller role.

To the objection that these recommendations may be sound but will not produce quick results, we reply that this is a good reason for implementing them sooner rather than later. To the objection that they are politically impracticable, we can only answer that many of the more effective policies being pursued now were so regarded a decade ago. We do not interpret the task of the economist as being to judge what is politically practicable, but rather to determine what are likely to be the most effective solutions. More informed public debate on these issues can only be fruitful.

3 THE TRADE AND INDUSTRY COMMITTEE'S REPORT ON TAKEOVERS

The Trade and Industry Committee's report (henceforth 'TIC Report') shares the scepticism expressed in our Report and in the Colloquium about the value of many takeovers and on many other matters. It goes further than we did in drawing a distinction between contested and uncontested bids: the latter it describes as "a sign of economic vitality", though it also recognises that hostile bids can be a spur to efficiency.

Although the TIC Report repeatedly asserts that the effect upon competition should be the main concern of official judgements in takeovers, it takes for granted, in contrast to our own Report, that the present concept of competition is adequate and it does want broader matters of the public interest to be taken into consideration at the outset.

The main underlying assumption of the TIC Report is that much tighter control of takeovers is desirable. It is not shy of making recommendations, with a total of 34, most of them involving government action. Apart from exhortation to companies and their institutional shareholders to appoint non-executive directors and otherwise strengthen their links and the information available, none of the proposed action is directed at the underlying forces favouring takeovers.

Most of the recommendations, in fact, deal with a tightening of existing controls and procedures, or with measures designed to make bids more difficult. Central to the TIC Report proposals is the creation of a new Competition and Mergers Authority, which would place the MMC and those parts of the OFT concerned with mergers in a single body. Even if the existing separate structures were maintained, a considerable strengthening in staff resources is proposed. Whilst the OFT and the MMC probably do need more resources, it is difficult to justify the loss of the advantage of the separation of the decision to refer from the judgement on the case itself. The Committee recognises this by proposing that the two functions should remain separate within the new body. At the same time, the Takeover Code and Panel should be placed on a statutory basis in line with the EC directive, despite the deficiencies of the latter and the risk that it would encourage tactical litigation.

The Committee also wants to open up the policy process by requiring the Secretary of State to give reasons for referrals and to invite public consultation before deciding on major changes to referral policy. This

is to be welcomed, as is the proposal that the Director-General of Fair Trading under existing arrangements, or the new Authority, should be given greater independence in formulating its policy on references, while the decision to conduct a full investigation would rest with the Authority and not the Government. The Secretary of State however might, as at present, permit a merger which has received an adverse report but, in contrast to present practice, disallow a merger which has been cleared by the MMC. This change would increase the politicisation of merger control.

The TIC Report recommends a number of changes intended to delay the merger process or make it more difficult or costly. Some of these recommendations in particular might have perverse effects. The Committee recommends that the mandatory bid threshold under the Takeover Code should be lowered from 30 to 20 per cent, while the acquirer of 5 per cent who does not state an intention to bid within three months will be barred from bidding within 12 months. Clearly, these two measures could precipitate bids that might not otherwise take place, and the former would rule out large friendly stakes of the kind common in Japan and Continental Europe. The Committee also wants to see the suspension of dealings in shares under bid (the opposite of the present practice of the Takeover Panel, which tries to keep the market open in the interests of shareholders) and a statutory requirement for financing to be in place prior to a bid being made. (Like some of the other recommendations this could, by reducing the number of threatened bids, reduce pressures on managements for change and which are only followed by bids when those changes do not take place.)

Perhaps most controversially of all, the Committee recommends that unsuccessful bidders should pay 50 per cent of easily identifiable professional costs and lodge a bond for these costs at the time of making the bid. Whilst this proposal will no doubt be welcome to professional advisers, it is not likely to encourage the prudent use of resources by defending companies.

We have not referred to all of the Committee's recommendations but in total they clearly represent a significant extension of state intervention in the market for corporate control and a move away from reliance upon competition as the principal criteria for intervention. We do not share the Committee's faith in the ability of the MMC or the new Competition and Mergers Authority to outguess the market, however imperfect that market may be, in distinguishing between, for example, which mergers

will have favourable or unfavourable impact upon regional economies. (Our reading of the evidence contained in our own Report is that *in themselves*, takeovers have not been an important factor in determining the level of regional prosperity.)

Another fundamental and more general objection to the more interventionist stance taken by the Committee is that most of the measures it proposes will have significant, though unforeseeable, costs and unpredictable benefits. Not the least of these costs would be the opening up of a divergence between the treatment of mergers above the £3.5 billion threshold at which they would be investigated by the EC, primarily on competition grounds, and those below that threshold but above £30 million, all of which would be investigated by the UK authorities on broader grounds. As the proceedings of the Committee reveal, for example, in a rejected passage: "In some cases this divergency might even put a small bidder, subject to the more onerous UK national merger control, at a serious disadvantage compared to a large (perhaps foreign) firm whose competing bid was subject only to the competition test of the Community merger regulation".

The Committee is clearly uncomfortable with the shift of control of larger mergers to Brussels and specifically recommends that where a merger is above the threshold but "may have a distinct effect upon the UK market, the Government should vigorously press the Commission for the merger to be considered by the UK competition authorities". It also recommends that the Government should oppose any future reduction in the current threshold and should press for its own rules about the payment of costs by unsuccessful bidders to be adopted by the EC authorities. It is ironic that the Commission, which is seen by the present government as undesirably interventionist, should in this case be on the same side as the UK government.

The Committee had another difficulty, revealed in its proceedings, that its desire to tighten controls on mergers within the UK might be seen to conflict with its wish to make it easier for UK companies to acquire continental European companies. This brings us to the fundamental criticism of the TIC Report, which is that in focussing almost exclusively upon the control of takeovers, it is proposing little that will do anything to reduce the pressure for takeovers: it is treating symptoms and not causes. The TIC Report draws heavily on US and Canadian experience in controlling takeovers without recognising that these countries share high levels of merger activity with the UK. Since these measures have

been ineffective there, they are equally likely to be ineffective here. Takeover activity in continental Europe and Japan, of course, is restricted not by tighter official controls but by differences in corporate ownership, governance and capital markets.

Where it does get close to the central cause of the problem in its treatment of the relations between institutional shareholders, the Committee recommends only "closer links" and echoes the call for the appointment of non-executive directors. It does not, fortunately, recommend any legislation on these matters. In our Report we say more or less the same thing, but make clear our view that not too much can be expected of the extension of non-executive directors. One problem is that there are dangers in mixing up the functions of executive and non-executive directors sitting on the same board. The logic of this points to the two-tier board structure, but this approach finds little favour in this country. Another danger of reliance upon non-executive directors which we did not mention in our Report is that it would, if pursued on a large scale, greatly increase the already significant number of interlocking directorships. This could threaten competition.

Finally, the TIC Report seems to accept that the case for referral on competition grounds can be determined by the application of simple rules in terms of market share and asset size. This is a static view of competition which we criticise in our Report, even though the MMC in practice adopts a more sophisticated approach to competition once a referral has been made. Even so, we doubt that sufficient attention has been paid in the past to the evidence of innovation and change which are the only unambiguous indicators of effective competition. Moreover, the TIC Report completely ignores the whole issue of barriers to entry, the removal of which we consider should be an important - if not the most important - element in competition policy.

4 THE HOUSE OF LORDS COMMITTEE REPORT ON INNOVATION

The House of Lords Select Committee Report (SC Report) rightly emphasises that innovation is central to economic progress. Its inquiry into this subject is essentially yet another investigation into the causes of the relatively poor performances, by international standards, of UK manufacturing. These official inquiries have been conducted with, it seems, increasing frequency for over 100 years. The famous economist Alfred Marshall, for example, gave evidence on the subject to a Royal Commission in 1886. In analysis, this Report is perhaps an exception among recent inquiries in that it does fully acknowledge that the problem has deep historical and cultural roots (reflected in our education system). The SC Report shows that there seems to be as strong a desire for intervention in economic affairs in the House of Lords as there is in the House of Commons. The Committee wants to see a reversal of the shift away from intervention and support for industry that has taken place since 1979. Their Report does not tell us why a return to the policies of the 1960s, which is what it proposes, can now be expected to work. Nor does it explain why the less interventionist policies adopted in the 1980s and which were, until 1988, showing signs of success should not continue to be given a chance.

It is certainly arguable, to put it at its mildest, that it was macro-economic policy which failed in the 1980s, not industrial policy (even though that policy was essentially not to have one at all). The productivity improvements and restructuring in UK manufacturing - including a greatly enhanced role for small and medium enterprises - that took place in the 1980s suggests that market forces can actually do far more in this country than government intervention ever did.

The principal recommendations which the Committee makes fall into four groups:

1. Exhortation for change in attitudes and behaviour on the part of companies, business schools, higher educational institutions and the financial sector.
2. Other matters, such as shareholder voting rights and the role of non-executive directors.
3. More generous tax allowances for training and industrial expenditure on R&D and free depreciation on plant and machinery.

4. More government expenditure on support for research and innovation and preferential interest rates for innovation.

On the first group, exhortation by Committees of Inquiry is not to be dismissed as entirely ineffective. It can help to speed up changes in attitudes where this is in any event being forced by economic and social forces. For example, the Reports of the Bolton and Wilson Committees on Finance for Small Firms seem to have stimulated change in the banking and venture capital sectors. It is to be hoped that this Committee's criticism of City Managers' insistence on dividend stability will help to promote a deeper appreciation of the mutual interest of fund managers, companies, and the mass of savers in investing in the future, in bad as well as good times. It also cannot be said often enough that manufacturing is important and offers creative careers for some of the best brains - which still, at present, tend to be attracted to finance, accounting and other supporting activities.

The second group of recommendations is more contentious and we have already considered the issues raised by them. We prefer to concentrate here on the much more important third and fourth groups which involve selective taxbreaks and (what amounts to the same thing) more government expenditure on industrial support based on "a strategic view of those areas in which we could or should have competitive advantage in the 1990s and beyond". These recommendations are clearly contrary to our own which rest on fiscal neutrality.

The Committee is aware that in making these recommendations, it is treading on sensitive feelings in some quarters:

> "Our recommendations will necessarily result in more Government interest and involvement in industry. While the mistakes of the past have caused these ideas to become unfashionable, the pendulum has swung too far the other way."

There are four powerful arguments against a return to government intervention in industry of the type the Committee wants to see.

The first is that if intervention is to be effective, then this inevitably means that the government must believe that its judgements are superior to those of business people in the market place. This is so patently untrue that the Committee specifically says that "we are not suggesting

that the Government should pick winners" - though it is difficult to see how this differs from the "properly targeted, selective Government support for innovation" which it actually calls for.

The second argument against intervention is that it involves taxing the successful to subsidise those whom the government in its wisdom believes will be successful in the future. Any increase in taxation to pay for industrial policies (or the postponement of tax reductions which might otherwise have been possible) weakens the financial resources of the majority of businesses and individuals which might invest in them. Moreover (thirdly), the potential errors in deciding where these public funds should be spent are compounded by new sets of distortions that would arise from the Committee's desire to allow more than 100 per cent tax relief on certain types of training and industrial expenditure on R&D. It is quite impossible to define training or R&D expenditure to include all the activities under these heads which businesses justifiably and properly engage in. Why, for example, should it be desirable to subsidise expenditure on the construction of prototypes at the expense of expenditure on in-house software development, or formal training at the expense of on-the job training? Free depreciation for plant and machinery, on the other hand, which the Committee also advocates, is defensible. There is no convincing reason why companies should be taxed on the basis of depreciation provisions determined by the Inland Revenue rather than by their own prudence. The Committee, justifiably, was unconvinced by the Revenue's suggestion that a return to free depreciation in this form would encourage poor quality investment.

The fourth and most powerful argument against industrial policy of the type recommended by the Committee is that, unlike its alternative, reliance upon market forces, there is no evidence that it works. There may be a case for subsidising strategic industries such as aerospace on the grounds that we should lose them if we did not; there is even a case for providing soft loans to small businesses on the grounds that the capital market does not work properly (as in Germany and Japan); but there is no case at all for subsidising particular businesses on the grounds that one day they, rather than the unsubsidised, will develop marketable innovations.

Although by chance some subsidised businesses must have produced spectacular innovations that, but for the subsidy, would never have reaped profits in the market place, the proponents of this type of state aid never seem to be able to think of any convincing examples. There is

no evidence, as far as we know - the Committee certainly does not provide any - that collaborative research programmes of the type beloved of the European Commission, or selective innovation support programmes of the type which even our present government thinks fit to introduce (SPUR, for example), do any good.

It does not seem to be true that our international competitors do any better than we do with programmes of this sort. The success of German, Japanese and, for that matter, American manufacturing industry can have very little, if anything, to do with the relatively small amount of money they spend on these programmes. The vast majority of public funds spent on aid to industry in these countries, certainly in Germany, is spent on regional policy and in the support or rationalisation of declining industries: it is not spent on growth industries. Nor, even, is the portion of national R&D expenditure accounted for by the government in the UK below the average for other advanced countries.

What does distinguish Japanese and German policies towards industrial structure is the amount of attention devoted to intervention in capital markets, and in particular to the promotion of small and medium enterprises (SMEs) (see BANNOCK & ALBACH 1991, for example). The United States also has somewhat more aggressive policies towards the promotion of smaller enterprise than the UK, though there was a pronounced shift in favour of SMEs here in the 1980s. The consequences of these policies should not be exaggerated, but they do reflect a less tolerant attitude towards excessive concentration than exists in the UK. Government intervention in industry, and in policies affecting industry in Britain, has generally favoured concentration to a greater extent than elsewhere. As we demonstrated in our Report, the shortcomings of British industry certainly cannot be attributed to a lack of large firms.

Michael Porter (1990) reminds us that the UK is deficient compared with more successful economies in the number of domestic suppliers in most sectors: in other words, its industry is over-concentrated. (Import competition alone is not enough, since it does nothing to promote the local support industries which seem to be necessary for export competitiveness).

It does not appear that official planning of the 'top down' variety, or the promotion of national champions, has contributed anything in France, or for that matter in Japan. In fact much of Japan's successful industrial structure, for example its exceptionally large SME sector, has come

about contrary to the wishes of MITI which, like official bureaucracies everywhere, tends to favour high levels of concentration in the private sector (FRIEDMAN 1988).

Why then do people continue to advocate, and governments to introduce, complicated selective industrial support programmes for innovation? The reason must be that governments want to be seen to be taking decisive action. There is a presumption that to state the problem - in the Report's language, "a shrinking manufacturing base" - is to imply the solution: 'more government support'.

It is in fact somewhat misleading to state that our manufacturing base is shrinking. The truth is that output in manufacturing at current prices has risen less rapidly than total output so that the share of manufacturing in GDP has fallen. Although it stagnated between 1969 and 1985, real manufacturing output in the UK in 1990 was 11.6 per cent higher than in 1979, that is to say it was - and remains - at record levels (CSO 1991). What has shrunk is manufacturing employment, which fell by over 2 million or 29 per cent from 1979 to 1990, and has fallen further since. The share of manufacturing output in GDP between 1979 and 1988 fell in all six countries shown in the table, though the UK and US declines were faster and there was little significant change in Japan[1].

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1 The share of manufacturing in GDP can fall even when real output is increasing, not only because output in the service sector is increasing faster, but also because manufacturing output prices typically rise more slowly than service output prices. This is because there is more scope for productivity gains In manufacturing than in services. BAUMOL et al (1989) have demonstrated that in the United States there has been no long-term decline in the share of manufacturing in real output, and that to this extent the fall in the share of manufacturing in GDP is a statistical illusion. This does not seem to be the case in the UK, at least since 1967, though a large part of the decline here is attributable to relative productivity changes.

Manufacturing output as a percentage of GDP

	1979	1989
France	24.8	21.3
Germany	33.8	31.1
Italy	28.3	23.2
Japan	29.3	28.9
USA	23.8	19.3 (1987)
UK	28.2	23.2

Source: At current prices, from OECD 1991 and CSO 1991.

None of this lessens concern about the relative performance of the UK economy, which remains poor, but the exceptional improvement in productivity in the 1980s owed nothing to interventionist policies. What should give even greater cause for concern is the continuing shrinkage in the number as distinct from the size of large UK companies. As demonstrated in our Report, the number of UK quoted companies fell from 3585 in 1973 to 2054 in 1988, and has since fallen further to 1955 companies (1991).

The expansion in the SME sector has yet to result in the emergence of a sufficient number of new medium and large companies to challenge the existing ones. Many of these new companies are in fact being acquired by large firms, as have been many of the existing ones. The absorption of Plessey by GEC and Siemens was a case in point that gave no cause for concern under the present concept of competition which we have criticised. The policies of support for manufacturing advocated in the SC Report would do nothing to help this situation; indeed, they would exacerbate it, because the record shows that the vast bulk of aid of this kind goes to the largest firms.

As we argued in our Report, what is needed - and has not yet been tried in this country - is a consistent, long-term policy to promote competition oriented towards innovation and the removal of barriers to entry and tax distortions favouring concentration and the separation of ownership and control.

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SPEAKERS

Mr. Geoffrey G. F. Barnett, Director General, The Takeover Panel

Sir Adrian Cadbury, Chairman, Committee on the Financial Aspects of Corporate Governance

Professor Sir Charles Carter, Vice-Chairman, Trustees of Joseph Rowntree Foundation

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