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A New Industrial Strategy : Preparing Europe  
for the Turn of the Century.

by

Keith Cowling

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A New Industrial Strategy : Preparing Europe  
for the Turn of the Century

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September 1989

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## The Challenge : Eurosclerosis

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The contemporary European economic problem is usually identified in terms of persistent, large-scale unemployment, and, since full employment is a legitimate and highly desirable aim, this is indeed an important indicator of economic malaise. However full employment is clearly not a sufficient description of the absence of economic problems. In responding to Eurosclerosis we not only require a dynamism that enables sustained full employment but also one characterised by a sustained high rate of productivity growth, where such growth fully recognises, in terms of its measure of output and input, both green issues and the contribution of extra effort in all its dimensions.

One level of response to an emerging crisis of large-scale unemployment would be to see it as essentially a demand-side problem with Keynesian policies as the appropriate reaction. Obviously this is not the place to get into the details of the appropriateness of changes in demand side policies as a remedy for eurosclerosis, nevertheless there needs to be a clear recognition that whilst appropriate monetary, fiscal and exchange rate policies can make major contributions toward enhancing the performance of the European economy, such policies only deal with the symptoms of deeper problems. Whilst the move away from Keynesian strategies in the mid-seventies certainly played a significant role in the emergence of Eurosclerosis, reimposing Keynesian solutions now, without a coherent supply-side strategy, will repose all the old questions which precipitated the original move away from Keynesianism. Indeed this has already happened in the UK with the Lawson "boom" of 1988 precipitating rising

inflation, despite 8% unemployment, and a large balance of payments deficit, despite the much-vaunted, market-based supply-side revolution. When put to the test, the British economy appeared not to have the flexibility or enterprise to adequately respond to a quickening in the pace of expansion of demand, and the imports came flooding in.

Whilst the British economy is particularly weak it does reveal a general sharpening of the issues surrounding Keynesian reflation, as was revealed in the early-eighties by the short-lived dash for growth in France. The integration of the international economy has moved dramatically on. Simply stimulating demand in one country may have only a limited impact on production in that country, but a major impact on its trade flows, and therefore on its balance of payments. International policy coordination may appear to offer a way out, but in the short-term it is going to be difficult to achieve and in the longer-term its technical and political solution by no means guarantees those policies to be full-employment ones. For that, deeper economic and political changes will be required - I shall return to these matters at the end of this paper.

Turning to supply-side issues, there has been much comment recently on the difference between Europe and the United States in terms of the recent record of unemployment, with the implication that Europe needs to move towards the more flexible labour markets that characterise the US economy, see, for example, Alan Blinder (1988). It is certainly the case that the recent record of unemployment in Europe has been much worse than for the United States, with the average rate in OECD Europe rising from 3% in 1973 to 11% in 1986, whereas in the case of the United States the rate increased by only



two percentage points, from 5% in 1973 to 7% in 1986. However a number of interesting points can be made about this particular comparison. First, it appears to be only relatively recently that the greater flexibility of United States labour markets has led to a superior performance in terms of lower unemployment, despite the fact that this flexibility is no new phenomenon. Comparing for example the United States with the United Kingdom, in the sixties the US averaged 4.8%, with the UK at 1.9%; in the seventies the US rate rose to 6.1%, with the UK rising to 4.3%, and it was only in the eighties (up to 1986) that the ranking was reversed with the US at 7.8% and the UK at 10.6%, despite all the best efforts of Mrs Thatcher to create labour market flexibility!

Second, Europe in the seventies and eighties has been characterised by enormous diversity in terms of recorded unemployment, with unemployment rates in 1985, for example, ranging from 0.9% in Switzerland to 22% in Spain. However it is clear that those with the lowest unemployment rates do not have the flexible labour market characteristics of the United States. Switzerland (0.9%) and Norway (2.5%) can be seen as special cases, the former exporting the problem, the latter benefiting from an enlightened response to North Sea Oil, but Sweden (2.8%) seems a more interesting case, one described as "Social Corporatism" by Glyn and Rowthorn (1988). This policy involved the state in active labour market policies allowing industrial jobs to be retained, retraining to take place and wholesale shakeouts to be avoided. As a result Sweden was able to maintain a very low level of unemployment throughout the seventies and eighties.

The third point about the comparison between Europe and the

United States is that the apparent dynamism of the United States economy, which has created such a growth of employment in the seventies and eighties so as to limit the growth of unemployment to a comparatively low level compared with Europe, is not manifest in the productivity growth rate of the United States. Over the period 1973-85 productivity growth averaged 0.6% p.a., leaving most of the 2.5% growth in GDP explained by the considerable growth in the labour force. As Freeman (1988), has pointed out, per capita GDP has grown at similar rates in the US and in OECD Europe over the 1970s and 80s, the difference being that US residents have worked harder for the same gain in living standards, and future living standards will be lower given the accumulation of significant external debt.

The observations made above about Europe and the United States would suggest that (i) the much vaunted labour market flexibility of the United States seems not always to have resulted in relatively low unemployment; (ii) there would appear to be an alternative European model for achieving full employment and (iii) most of the growth of GDP in the United States has been due to the growth in employment, with productivity growth at a very low level. But if the United States fails to offer a convincing model of the way forward what of the Swedish way? Over the period 1973-85 the analysis of Glyn and Rowthorn suggests that the growth of unemployment in OECD Europe is closely linked to the decline in industrial employment, whereas there appears to be no significant link between unemployment and service employment. They argue that displaced industrial workers are not taken-up in service sector employment for such reasons as skill, age, gender or location. Many countries have lost industrial jobs at a rapid rate, for example Spain, the United Kingdom, Belgium,

Ireland, the Netherlands and France, and such industrial crisis has become a crisis of unemployment. As they put it, the rundown in industry creates a pool which fails to evaporate because it is not in contact with the central core of the labour market.

The Swedish model of Social Corporatism appears, at first sight, to offer a way out. The link between industrial crisis and unemployment crisis is broken by active state intervention in the labour market involving relatively durable compromises between employers and employees. But, of course, in the longer term this is insufficient. For this sort of corporatist response to survive, and the Swedish solution has been showing signs of breaking-up, the underlying more fundamental problems which lead to industrial crisis have to be addressed - the problems which give rise to industrial decline, which in turn precipitate the problem of structural unemployment. Some indication that these more fundamental problems have not been fully addressed in the Swedish case is provided by its rather poor record on productivity growth, averaging about 0.7% over the 1973-85 period, which was less than half the OECD Europe average, and very similar to the US experience.

If, neither the United States nor Sweden offer an adequate model, to which country can we turn? Based on the record of recent history it is clear that Japan is in a unique position among the major economies of the advanced capitalist world in providing both full employment and a relatively rapid rate of productivity growth. Employment growth over the seventies and eighties has been almost sufficient to maintain full employment, the latest figure for unemployment is 2.5% in 1988, whilst at the same time a considerable

rate of productivity growth (3% p.a. for the period 1973-85) was maintained. It is also necessary to remember that this performance was achieved despite the period being a particularly traumatic one for Japan, faced as it was with an oil and commodity price explosion to which it was particularly exposed and over which it had little control, and more recently a dramatic appreciation of the yen.

Clearly the Japanese economy differs in many ways from the European and United States economies, but one of the differences is of particular interest in the present context: Japan has a coherent, strategic industrial policy unlike any other advanced capitalist economy, although some countries come closer to it than others. This might suggest the possibility of a dual track; supply-side policy for Europe, with an active labour market policy along the lines of the Swedish model aimed at avoiding industrial unemployment, leading into a coherent industrial strategy along Japanese lines, guiding the longer-term evolution of the industrial economy, aimed at dynamic growth. Before examining such an industrial strategy I will first consider why it is necessary and why it has become increasingly necessary in recent history. This will offer some insight into the basis of Japanese success and the route along which Europe might move forward.

### Why we need an Industrial Strategy

Within the capitalist economies there has, since the beginning, been a clear recognition that situations can arise where the public interest may be served by the supersession of the market by the collective action of citizens, acting via the government or via

other institutions.<sup>1/</sup> Traditionally these concerns have centred on monopoly power, externalities, the provision of public goods (in the narrow, technical sense) and issues of the distribution of income and wealth. Arguably, these issues could be resolved within the regulatory activity of the state, or, in the case of public goods, by public provision. Market failure, in these traditional senses, need not require that a coherent system of economic planning, an industrial strategy, be imposed on the private sector of the economy. This would be the orthodox view, but this view has never attracted one hundred per cent support. Some would argue that the evolution of the monopoly or oligopoly phase of capitalism poses such systemic threats to both microeconomic and macroeconomic efficiency, and to equity, and indeed democracy itself, as to require a coherent system of overall and continuing control which is much in excess of, and of a different nature to, any system of regulatory activity which is currently manifest. I would tend to this position, but it could be considered arguable so long as one restricts the basis of intervention to the rather narrowly interpreted, traditional arguments. Instead of developing the case at this point, I want to extend the terrain over which the argument will be fought.

Just as there are systemic arguments, which will not be rehearsed here, for relying on market forces to play a centrally important role in modern economies,<sup>2/</sup> there are parallel arguments for imposing on these market forces coherent, community-based, national and supranational economic planning systems, within which they are allowed to operate. At the present time there would seem to be three fundamental reasons: transnationalism, centripetalism and short-termism, all interrelated and all related to an underlying

concentration of power, and therefore decision-making, in modern economies. These are not new factors, but they have now assumed such significance that economic policy must now be fundamentally realigned to fully account for them.

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Transnationalism

The growth in dominance of the transnational corporation poses a significant potential threat for any national market economy. The global perspective and ambitions of the major industrial and financial corporations may cut across the interests of any particular nation state, or any particular community, whether or not such corporations have their origins in that nation or community, or some other. The fundamental issue relates to the asymmetry of power between corporation and community, which derives from the transnationality of the corporation - and the international perspective and flexibility which that implies - compared with the locational rigidity of a specific local, regional or national community. To achieve its own objectives the transnational can switch investment and production, or threaten to do so, whenever conditions in any one country or region appear disadvantageous, for example because wage costs or profit taxes are too high.

Thus any one nation can be deindustrialised by the actions of transnational corporations - and the implication is that only when wage costs are cut, or profit taxes reduced, will capital return. Thus, to protect itself, any community has to intervene in the strategy-making of the transnationals - or accept their dominance in its own affairs. To do so is to admit that a nation, or community, has no real autonomy.

But can a nation effectively control these powerful international organisations? There are obvious difficulties, the very basis of their power, but there is obvious source of leverage. Whilst the transnational will wish to produce at locations of minimum cost, for example where wage costs and profit taxes are low, it also requires access to markets in order to sell its product. National communities can deny, or threaten to deny, access to national markets. Thus, access may be tied to production within that nation.<sup>4/</sup> This implies a willingness to intervene in international trade - a movement away from free trade towards "managed trade". But this is not a new concept. We only have free trade at the moment in the sense of a general freedom from the state intervention.<sup>5/</sup> Trade is managed by the transnationals: most trade is intrafirm and is therefore directly controlled by these corporations, and much of the rest is indirectly controlled by them via sub-contracting, licensing and franchising arrangements.<sup>6/</sup> This control gives power to these organisations which can be used to secure their own objectives at the expense of communities which have no say in such decisions.

This is a perfectly general phenomenon. That is, without intervention, we are involved in a negative-sum game: national communities in general can suffer from the unrestricted activities of the transnationals. Any community considering a tax or wage increase will be faced with the possibility that capital will migrate in response. The general, system effect is that wages and taxes on profits will be held down against the wishes of each national community, and, similarly, subsidies to investment or production will be raised above what they might otherwise have been.

Thus we have a basis for recommending international regulations on the transnationals, and this is a matter for both East and West as the transnationals seek to extend their activities into the centrally-planned economies: but it is also a basis for establishing a role for a national, indeed a European, industrial strategy. We need a framework of strategic planning within which to position the transnationals. We need to approach them, and bargain with them, within the context of such a strategy, otherwise their strategy will inevitably become the national or European strategy and this may have little correspondence to what is best for that nation or for Europe. The transnationals are not a threat if their strategies are harmonised with the national economic strategy, but a necessary condition for such harmonisation is the existence of a national economic strategy. Having established such a strategy, cultural, political and economic pressure is required to ensure harmony is achieved and maintained. In this regard, we may have much to learn from the activities of various political groupings organised within Europe around green issues.

### Centripetalism

Centripetalism, the second reason we have advanced for requiring that a coherent national or community industrial strategy is an essential element of any efficient economic system, relates to the tendency for higher-level activities and associated occupations to gravitate to the centre - to be lost to the regions; to be lost to the periphery. This is really a generalisation of the issue of transnationalism, and indeed is one of its systemic features. At one



and the same time the major corporations are internationalising production and drawing the control of the use of an ever-increasing share of the world's economic resources into the ambit of the key cities of the world - cities like New York, Tokyo, London, Paris. Feagin and Smith (1987) refer to such cities as world command cities containing "... extraordinary concentrations of top corporate decision-makers representing financial, industrial, commercial, law and media corporations". In terms of headquarters location, New York in 1984 had fifty-nine of the top 500 transnationals (excluding banks), London had thirty-seven, Tokyo thirty-four, Paris twenty-six (Feagin and Smith, pp. 6-7). All cities with five or more of the top 500 were in the United States, Japan, Britain, France, Germany, Italy, Canada and Sweden. Korea was the only Third World country with a city containing the headquarters of two or more top transnationals: Seoul had four. Clearly most of the the top transnationals are in large cities, but many large cities do not have significant concentrations of this sort of global economic power. All the world's major transnationals are headquartered in a small minority of the world's largest cities. Within Europe, London, Paris and Essen/Frankfurt (with 25) dominate. A scattering of other cities across Europe contain small numbers of top transnationals' headquarters, from Stockholm (with 6) in the North to Madrid (with 2) in the South, but it is noticeable that Britain and France, who provide the two dominant European cities in terms of this measure of global economic power, do not provide any other entrants to the lists. Places like Glasgow and Edinburgh, Birmingham and Manchester, Marseilles and Lyons, seem not to count.

The transformation lying behind this current situation has

led to the loss of a substantial degree of local, regional and national autonomy. And this is not only reflected in the ambit of the biggest corporations, who are themselves typically transnationals, as normally defined. The control of such giants extends well beyond their legal bounds into most of their sub-contracting, agency and franchise relationships, see Cowling and Sugden (1987). The result is that strategic decisions with major implications for many local, regional and national communities are being taken outside those communities. The same centralising forces imply a siphoning-off of resources to the centre which reduces the capacity of the periphery to sustain its own economic, political and cultural development on which future self-determination is based. The almost inevitable outcome is the outmigration of the educated, leading to further decline in the cultural development of the community. Centripetal economic tendencies become centripetal political and cultural tendencies and the community enters a vicious circle of relative decline. It is also the case that such communities cannot easily break out of these processes of cumulative causation by supply-side adjustments, such as investing in education - which might be a typical response, so long as the demand side (for educated personnel) lies outside their control. Increasing educational investment will only effectively contribute to the economic and cultural resurgence of the community if parallel action is taken to secure some strategic control of production and investment and thus of the demand for educated personnel.

#### Short-termism

The third, and related, basis for requiring an industrial strategy is the systemic short-termism of the market as it has

developed in the twentieth century. Short-termism is related to transnationalism within the context of any one nation since the strategy of the major corporations will inevitably be more short-termist within that nation because they have only a limited commitment to it in the long term, at least as a location for production. Similarly in the case of centripetalism. The withdrawal of strategic decision-making from huge swathes of the world's surface and population will mean that more and more of the world economy will be infected with short-termism. Whilst the centre, the key city location, will be taken as a relatively fixed point, the periphery, the regions, will be viewed in a different light, according to a different calculus in which investment in the broader and deeper aspects of the community will not command serious attention. Whilst the cultural dynamism, or lack of it, of Birmingham or Lyons may have important long-term consequences for their economic dynamism, this may elicit little response from strategic decision-makers who are located elsewhere, without any long-term commitment to either city. The growth of the forces of transnationalism and centripetalism implies an increasing failure to internalise various dynamic external economies. Whereas previously locally-based industry could recognise the economic importance for them of "cultural" investment, this link has been substantially broken.

But short-termism is not purely a consequence of the forces we have already discussed, it is also promoted by the concomitant development of other organisational forms and institutions. In this context it is interesting to note that the advent of the multi-divisional corporation, of such importance as an enabling condition in the development of the giant transnational corporation, also

incorporated some of the seeds of short-termism within its structure. Profit centres (product or geographical divisions) are forced into short-term profit maximisation postures to justify being allocated capital for further investment, and thereby fail to take the long-term strategic aims of the corporation fully into account. Thus whilst the M-form corporation may be efficient in enforcing short-run cost-minimising behaviour and in securing an unbiased strategic posture for the corporation as a whole, there remain questions concerning the efficient implementation of long term strategy within the divisions. The widespread adoption of the M-form structure within Europe (particularly Britain) implies that this possible source of short-termism has become much more significant over the past twenty years.

I now want to turn to the much more familiar explanation of short-termism: that it relates to the short-term perspective of the financial institutions with Britain as the extreme case, but in a sense we can see the spread of the M-form corporation as an attempt to introduce the discipline of the financial markets within the corporate structure, where without it the external financial markets are constrained by their lack of adequate information. In Britain the short-term perspective of the financial institutions is undoubtedly linked to the historical role of the banks in financing trade and funding bond issues - as opposed to being directly involved in industry via equity or long-term loans. The situation in Germany and Japan at the other extreme has been different, with the banks being more closely tied to industry. But, it remains the case that, for most market economies, the question of short-termism is likely to loom large. What this generally means is that incremental change, which can be accomplished relatively quickly, can be handled quite well by

market institutions, but more fundamental changes, involving quantum leaps in product, process or structure, and therefore requiring an extended period of time for their fulfilment, will not be handled so well.<sup>7/</sup>

However, in a direct sense, the financial institutions themselves can only impose their short-term perspectives on industry via those firms otherwise incapable of raising finance internally. Thus new and small firms (especially in Britain) may be severely constrained in their investment ambitions by the short-term perspective of the (British) financial institutions, since it is these firms which will find it difficult to fund their own growth. In contrast the established, bigger corporations will generate substantial internal funds, will also be able to raise new equity on the stock market, will have considerable leverage, and can go abroad, where necessary.<sup>8/</sup> Thus larger, better-established firms will retain a significant autonomy. However an active market for corporate control - that is an active market in the control of existing corporations via takeover/ acquisition - could overturn all that.

Such a market allows the short-term perspective of the financial institutions to impinge much more decisively on the perspective of industry, which must of necessity, take the long-term view in terms of its own industrial logic. That is, to secure the firm's long-term future, action must be taken today which will often reduce short-term profitability. For example, research and development need give no immediate payout, but not to do it may leave the firm in a vulnerable position in the long term. Falling behind rivals may threaten survival. But, with an active market for

corporate control most firms will fall victim of the short-term perspective, given that to ignore it may lead to an unwelcome takeover bid.<sup>9/</sup>

Recent developments in the financial markets have dramatically increased the likelihood of such bids. Wall Street, immediately prior to the Boesky scandal, provided the most vivid example of this phenomenon, with the so-called triple alliance of corporate raiders, junk bond dealers (merchant banks selling high yielding bonds created to finance takeovers) and arbitrageurs (people taking positions in companies they predict will be targets for corporate raiders), but the situation in London is very similar, and indeed closely connected.

This sort of financial environment is hardly conducive to the rational planning of the long-term future of the industrial base. Short-term decision making is crowding out long-term issues, and leaving industry weaker in the long-term. No one is planning for the future in such market environments. Thus, within our market economies, we need to establish mechanisms and institutions to do this; and in the case of planned economies, moving toward the extension of product and capital markets, as in Eastern Europe, the requirement for the continuation of the planning of long-term investment has to be recognised.

Thus three central tendencies within modern market economies have been identified; transnationalism, centripetalism and short-termism, which taken together point to the requirement for national/community economic planning in order to achieve efficiency in

the allocation and utilisation of national community economic resources. However, under modern economic conditions, and perhaps more generally, comprehensive centralised planning is both infeasible and undesirable.<sup>10/</sup> It can therefore be concluded that although planning can be seen as essential for reasons of efficiency, the nature of planning is all important. I want to now turn to examine a planning model which appears to have been used with enormous success, namely the Japanese model, to see if we can learn something of the nature of planning which may be capable of adaptation to the European situation. Japan appears to have been able substantially to transcend the forces we have analysed by purposive national action. Not only that, but they have done it in a hostile world where United States and European based corporations were in a clearly dominant and dominating position.

## The Nature of a Future Industrial Strategy<sup>11/</sup>

### The Japanese Model

Two roles for the state in a market economy can be identified: a regulatory one and a developmental one, see, for example, Chalmers Johnson (1982). The regulatory role is a traditional focus of state intervention in economies like Britain and the United States, with the state acting to remove market imperfections, acting as an adjunct to the market, working at the edges of the market system. In contrast, in its developmental role the state acts to shape the industrial landscape, taking a leading role in the industrial economy - a proactive rather than reactive role, with the market continuing to play a substantial, indeed

crucial, part, but working within long-term parameters set by government, at various levels, for example local, regional, national and supranational. With the centrality given to the market within orthodox economics discussion of policy is often confined to the regulatory role of the state, to the neglect of the developmental role. Where the developmental role is addressed it does not flow from the analysis of markets where the government is identified as a potential actor, but normally deals with the government as producer of physical or social infrastructure, acting as a replacement for the market institution where market failure is identified. But, in addition to this role, we need also to assess the potential direct role of government in the strategic decision-making within the market - within the corporate economy. It seems to have required the intercession of political scientists, like Chalmers Johnson, to identify the full, potential significance of this role within the modern market economy.<sup>12/</sup>

Within Britain and the United States the state has acted as a developmental state from time to time, and indeed Japan based its policy on the nineteenth century success of US developmental policy, see Johnson (1984); but this has not persisted in any systematic form.<sup>13/</sup> Europe and the United States has not seen the fundamental intervention within the market economy as has typified the Japanese economy. Y. Ojimi (the Vice Minister, MITI) has remarked about the United States and Europe:

"industrial policy (meaning developmental policy) has amounted to a collection of measures that are an exception to the rule, and of but a fragmentary or transitional



nature", OECD (1972)

Japan is the most important case of the state taking on a central developmental role in the economy without directly owning most of the productive assets.<sup>14/</sup> There are other cases of market economies where the state has a developmental role within that part of the economy which it directly owns and controls, but where otherwise it does not systematically seek such a role. Perhaps Britain, pre-Thatcherite, most of Western Europe, and India would fall in this category. Generally, it does not appear that such activities have been used as a basis of a coherent national economic planning system.

Within Japan, although various departments and agencies of the state are involved in industrial strategy, MITI - the Ministry of International Trade and Industry - has a central and dominant role, see Chalmers Johnson (1982). What is the nature of such planning.

MITI targets certain key sectors of the economy, chosen after wideranging consultation and discussion throughout industry, and works to ensure, by a variety of interventions both carrots and sticks, that those sectors grow rapidly and efficiently. One key factor at the time of rapid development in the 1950's and early 60's was to protect domestic industry until it was fully internationally competitive. At the same time a substantial degree of domestic rivalry has evolved in most industries selected for this treatment. MITI relies heavily on market forces to support its own measures, and is undoubtedly helped in this by the long-term perspectives of the typical Japanese industrial firm, untrammelled by the threat of an active market for corporate control and supported by the long-term

15/  
commitment of Japanese financial capital.

The Japanese saw early on that static comparative advantage was not an adequate basis for national economic development. After World War II that would have left them as producers of rice, cheap toys and simple textiles. To break-out into other areas of economic activity required that the state should be directly involved in the economic system. The market could not be relied on. Within the market there are vicious and virtuous circles of cumulative causation - once you get behind the pack the market will normally ensure that you get pushed further and further behind.<sup>16/</sup> The market had to be managed and directed - a national economic strategy had to be imposed, but leaving the market to do what it is good at doing: looking after all the myriad, incremental changes which are required within the broad strategy, and, of course, running those sectors which don't require strategic intervention. A well-developed international trading system removes any requirement that national planners need be involved in the detailed input projections for a whole range of industries, which has often been seen as a central requirement in much national planning.<sup>17/</sup> Attempting to be comprehensive is generally a diversion from attending to the crucial matter of the strategic planning of key industries and providing the necessary infrastructure for a dynamic industrial base.

#### Adapting the Japanese Approach

I have quite deliberately chosen not to go into the detail of Japanese planning; its various instruments, institutions and mechanisms.<sup>18/</sup> These are a product of its own history and culture and

it would generally be wrong to consider that they could, or indeed should, be transplanted to countries characterised by quite different historical and cultural circumstances.<sup>19/</sup> What it is important to learn from the Japanese case is the approach to the problem. To begin to be as successful with our economies as the Japanese have been with theirs will require the same degree of commitment by the government to economic development as has been the case with Japan. At the same time we have to learn the other lesson of the Japanese experience; that the role of the state should be limited to the strategic oversight of development, rather than getting involved with the operational detail, and that strategic oversight is only essential in the case of a limited array of key industries, many sectors being left to market processes without strategic guidance. The role of the state has to be seen as catalytic, proactive rather than reactive, bringing guidance where the market offers little. Policy in most western countries tends to be adhoc and reactive because of suspicion of state planning, whereas in the centrally planned economies there is suspicion of the market by some and of planning by others. The message of the Japanese experience is that, properly organised, planning and the market are complements rather than substitutes. Each has to be allocated its appropriate role.<sup>20/</sup>

The success of the Japanese economy is obvious. But how much of this success has been due to planning? In everything I have said I have assumed that that success has been related to a substantial degree to the developmental role of the Japanese state. And yet the question has no answer in the sense of ascribing a certain fraction of the Japanese growth rate to the presence of Japanese industrial policy, with its related institutions. What I believe can

be said is that their industrial policy, operated mainly by MITI, was a necessary, but obviously not sufficient condition for Japanese economic success. It could not have been achieved without MITI, and despite my earlier assertion about Japanese institutions not being easily transplanted, I believe that something akin to MITI will have to be constructed in any country, or group of countries, seeking a successful, proactive developmental role for government. Such an institution would have to incorporate a small, entrepreneurial, bureaucracy dedicated to thinking strategically about the economy, and with the independent capability of implementing the strategy which evolves from the process of wide consultation with industry. Such an institution would have to provide continuity, consistency and commitment to the processes of economic development. In the case of Western Europe this implies a move from adhoc intervention towards a coherent strategic policy, with a proactive stance replacing a largely reactive one. In the case of the centrally planned economies, it requires a greater devolution of control to the market, coupled with the establishment of strategic planning by the state in certain key sectors, achieved via consultation and consensus wherever possible.

#### The Debate in the United States

The early eighties saw an intense, but short-lived debate on industrial policy in the United States see, for example, Norton (1988). It was natural that it should occur in the United States, given that it appeared to be losing its industrial supremacy, and it was natural that it should focus on Japanese industrial policy given that its supremacy was being challenged primarily by Japan. The debate petered-out in 1984 with the reelection of President Reagan, but

emerged again in the recent presidential campaign, stimulated by Jesse Jackson, responding to the vision of Sam Bowles, see, for example, Sam Bowles et.al. (1984) and Michael Dukakis, influenced by Robert Reich, see for example, Reich (1984). Whilst the defeat of the Democratic candidate has put the debate on ice again, the fundamental issues remain and a rekindling of the debate can be expected as the current period of substantial growth begins to founder, as it now appears to be doing.

Despite some powerful and articulate advocacy in favour of the initiation of a national industrial strategy, see, for example Reich (1983), the consensus view in the early eighties appeared to be that the United States already had one: "the policy is that we don't want an industrial policy" [Assistant Secretary for Commerce, see Johnson (1984)]. The mainstream economics profession provided powerful support for this view, Norton (1986). Interestingly, these same people, who denied the relevance of industrial policy at that time, for example Paul Krugman (1983), appear not to have been swayed in their beliefs by the appearance of theoretical models of international trade, which they have played a major part in developing, which suggest a role for trade policy and/or industrial policy, see, for example, Krugman (1987). In an oligopoly world, comparative advantage is endogenous and can be "shaped", Brander (1987), but free trade/laissez faire policy is redeemed on practical (second best) grounds. Whilst this looks rather unconvincing on its own terms - there seems an excessive concern to justify a laissez-faire stance despite the implications of the theory, I feel that what is lacking is a focus on the powerful agent in all this; the transnational corporation. Industrial policy/trade policy, and the

two cannot be meaningfully separated, is required to secure national welfare in a world of transnational agents. Despite the "new" industrial organisation embedded in the "new" international trade theory, the essence of the problem is still missing. In securing national welfare, national producers are assumed, and trade policy/industrial policy which provides advantages to such producers raises national welfare via the rents they are able to capture in the process of strategic competition. Interestingly, transnationalism is offered as a further reason for not adopting a strategic trade policy - because the beneficiaries are not national firms, and thus national welfare may not be enhanced, see Stegemann (1989). This reveals the poverty of the analysis. The focus should be on national welfare, not the welfare of national firms with transnational coverage/ownership. Optimal strategies should reflect the ambitions of national communities rather than the ambitions of powerful firms with no particular allegiance to any national community.

The rekindling of the debate is unlikely to emerge in the mainstream of the economics profession: the excessive convergence of mainstream economics in the United States on a rather narrow, neoclassical orthodoxy precludes this. Rather it will be rekindled within the radical economics of the left, within political science and within the business literature. These are the areas which allow intellectual space for an active role for the "community" in the evolution of a policy for industry, albeit with widely different constructions of the notion of "community".

Although my objective is an industrial strategy for Europe, I have taken time to consider the debate within the United States

because it is obvious that our profession is dominated by what goes on there, and, inevitably, positions established within Europe regarding industrial policy will, to a substantial degree, reflect the outcome of debates within the United States. But I am seeking to develop the debate within Europe and it is clear that there is substantial disenchantment with the market in the West (coupled with a turning away from state enterprise) and with planning in the East, leading to a search for a solution which combines the virtues of both market and planning, without the obvious vices. I feel the Japanese model offers an important point of reference, but we must approach our own national problems unfettered by any presumption that the precise institutions and mechanisms of Japanese planning can be easily transmitted for use under very different conditions. The important point is to recognise that we can learn from the Japanese approach and experience. In doing so we observe that the Japanese approach evolved over time as a result of their experience, but also in response to changing circumstances. The lesson is that we need to be organisationally innovative in our approach to planning, whilst maintaining a continuity and consistency in our overall purpose. I want to now turn to a vision of the future to which this purpose could be directed.

#### Creating an Extended System of Flexible Specialisation

Adams and Brock (1988), in an important survey article aimed at debunking "the Bigness Mystique", demonstrate convincingly that the creation of the European industrial giants as a result of the merger boom of the sixties was to a large extent disastrous in efficiency terms.<sup>21/</sup> They also contrast European experience with that of Japan where a similar merger wave failed to materialise. The comparison

points unambiguously to the superior efficiency-creating properties of the deconcentrating tendencies which generally dominated within Japan, in some cases despite government policy to the contrary. On the basis of this evidence the authors argue for a stringent policy on merger.

However, whilst the analysis of Adams and Brock is both important and correct, I believe it is also incomplete. If bigness is a problem, a problem largely created by the laxity of post merger policy, then it is certainly correct to argue for stricter merger policy now and in the future, but it is unlikely to be sufficient. Not only is a policy required to control the further growth in dominance of the giant corporations, but the problems posed by that very dominance have to be addressed. I believe they should be addressed as issues of regulation, but also as issues of development. Not only do we, as democratic communities, need to react to the accumulated power of the major actors on the economic scene, in terms of regulating their behaviour, or divesting them of at least some of their power, but we also need to act strategically to counterpose our own vision of the future to that of the dominant corporations. Thus the regulatory and developmental roles of government are complementary in the search for a dynamic and efficient economy. Economic power is being concentrated in fewer and fewer hands and this in turn is generating forces, the forces of transnationalism, centripetalism and short-termism, which progressively undermine the ability of people, and the communities of which they are part, to assert their right to determine their own future. This is the essence of democracy - the ability of people and their communities to allocate resources in the way they choose. Thus economic democracy is fundamental to maximising a community's economic welfare. To begin to achieve economic



democracy, people and communities have to possess some significant degree of direct control over the dominant centres of economic power - they have to possess regulatory control, but also the capacity and power to develop effective plans for the economic development of the community or nation as a whole. In theory this requirement for economic democracy fits very easily within neoclassical economics since the neoclassical view is all about individuals making choices. In practice it tends to cut across the grain of neoclassical analysis which assumes an even distribution of power, thus ignores power asymmetries and therefore fails to grasp the requirement for democracy within the functioning of the economy.

Thus industrial policy should not be about creating national champions, Adams and Brock are absolutely correct in seeing that an industrial policy based on giantism is no way forward, but rather it should be about creating a more dynamic, more participatory, more cooperative economic and industrial base. Perhaps the most fruitful way forward is provided by what Piore and Sabel (1984) refer to as flexible specialisation. This relates to the modern re-creation of many of the characteristics of traditional craft production, now incorporating technologically sophisticated, highly flexible processes, within a strategy of permanent innovation in terms of both product and process. Rather than seeking to replace skills, the basic thrust is their enhancement; rather than seeking to control workers the emphasis is on participation and cooperation. The basic unit of production tends to be small-scale, in some cases incorporated into larger enterprises, but usually organised as networks defining geographical, industrial districts. Piore and Sabel identify such districts in parts of Italy (for example, Emilia Romagna), West

Germany (for example, in Baden-Württemberg) and Japan, and argue convincingly that these structures have been better able to adapt to the turbulence and uncertainties of the seventies and eighties than has the system of mass production of standardised products, which had become the dominant mode of production in the last century.

Because of its revealed superiority of performance in recent decades many are expecting flexible specialisation to increasingly crowd-out the system of mass production operated by the giant corporations. In this regard it is interesting to consider the dynamics of the growing fragmentation of production taking place via market exchange but within the strategic control of the giants. Can we expect a more autonomous development of flexible specialisation to take place from within such beginnings? Will relatively small subcontracting firms find it possible to move out from under the umbrella erected by the giants? It is certainly possible to point to cases where this has occurred, for example in Italy and Japan, but it is unlikely, as a generality, unless and until a supportive environment is created by the relevant national, regional or local state. In Emilia-Romagna it was provided by a strong political connection between the new entrepreneurs and the local and regional state, see Brusco (1982); in Japan it was related to the provision of a large number of local innovation centres, see Piore and Sabel (1984: 223). Without this sort of support, successful experiments in the area of flexible specialisation are likely to succumb to the powerful advances of the giants, manifest via acquisition or predation.<sup>22/</sup>

Thus to create thriving regional networks of relatively small, independent, enterprises requires that our industrial strategy

be articulated at that level. The aim is then to create a mutually supportive set of firms and institutions located within a specific district, protected from the predations of the giants and provided with a modern infrastructure. Thus our industrial strategy has to be devolved and decentralised, but with a national coherence. Government will always need to work at several levels: at the national or supranational level when confronting the national or transnational giants; at the local or regional level when nurturing the networks of small local or regional firms.

#### Concluding Remarks

At a time when people are predicting the loss of two million jobs in the throes of 1992. Europe needs to begin to construct a vision of its future. This is particularly appropriate at this time given the forces which are propelling us towards a Greater Europe where East and West are increasingly integrated, economically and politically. I have argued that we need to learn from the approach of Japan to its own development. We need to understand how it has harnessed the fundamental forces of its own market economy to its national development. The present significance of the forces of transnationalism, centripetalism and short-termism provides strong grounds for active intervention in strategic decision-making in industry at both national and European level. Europe needs an institution, or institutions, dedicated to thinking strategically about the economy, and with the independent capability of implementing the strategy which evolves. The supranational position of the EC can provide institutional arrangements whereby competitive and self-defeating national strategies can begin to be avoided, but such

strategies have to be informed by a vision of the future Europe. I have suggested that we should not be supporting the notion of national or European champions - giants on the world scene - but rather should direct our energies towards creating an environment in which relatively small, dynamic enterprises can survive and prosper and begin to develop a new sense of community within Europe.

Footnotes

- 1/ As we shall later argue, we do not consider Keynesian intervention to secure full employment in the same light. We regard such demand-side intervention as enhancing the market system, or indeed saving it, rather than superceding it. We do not deny its fundamental importance.
- 2/ The changing boundary between firm and market is not the focus here. Market is used as a conventional, if somewhat misleading, shorthand to distinguish the private from the public domain.
- 3/ A more complete argument is developed in Cowling and Sugden (1987).
- 4/ Membership of the European Community raises additional difficulties at the level of the nation state, but additional possibilities for controlling the transnational activities of these corporations. It dramatically raises the central issue of the dimensions of "community", within its supranational policies with respect to organisations like the transnationals and its regional policies directed at specific communities.
- 5/ I am referring here to the general relaxation of trade barriers within the capitalist system over the post-World War II period. I am well aware of the many impediments to trade that continue to exist.
- 6/ Clairmonte and Cavanagh (1981) estimate that the transnationals

account for 70-80 per cent of world trade outside the centrally planned economies.

- 7/ It is also the case that many possible alternatives to the market would fail to adequately handle these matters. My interest in the Japanese model (see later) was triggered partly by the apparent success that has been achieved in the case of Japan in making exactly these quantum industrial leaps.
- 8/ Note however that the importance of external finance appears to be very different in different countries, see Colin Mayer (1988). Despite having relatively undeveloped stock markets new equity in Germany and France makes a bigger contribution to domestic investment than in the USA or Britain, and whilst bank loans are very important in Japan (accounting for 42% of financing) they are relatively unimportant in the UK (accounting for only 7% of financing).
- 9/ Note again that conditions in different countries are very different. Whilst in the case of Britain and the United States such a market in companies is highly developed, in West Germany and Japan it scarcely exists, see Jonathan Charkham (1989).
- 10/ This point need not be belaboured; even its previous exponents are in total, and often chaotic, retreat.
- 11/ Industrial policy could be seen to have two basic dimensions: changing the nature of the firm, for example by legislation aimed at opening it up to a wider membership, and changing the

environment within which the enterprise operates, for example, by imposing a national industrial strategy. This paper concentrates on the latter, although it is clear the two dimensions of policy are not mutually exclusive.

- 12/ We shall return to this matter when we consider the debate among economists, particularly within the United States, about Japanese-style industrial policy - its importance in Japan and its relevance to other advanced industrial countries, particularly the United States.
- 13/ The pressure for government to maintain such a role in the economy is likely to be less marked when that economy has established a world lead. The pressure to adopt such a role will be more intense when such a lead is lost; or being lost, or where the country in question has been late to industrialise.
- 14/ It is interesting to note that the other dramatically successful economies of the Pacific Rim - South Korea, Taiwan, Singapore and Hong Kong, have organised themselves in rather similar fashion, see, for example, Lim (1988) and White (1988).
- 15/ Colin Mayer (1988) draws a sharp distinction between the general lack of long-term commitment to industry of the banks and other financial institutions in Britain compared with the situation in Japan: "what is normally described as debt in Japan has all the characteristics of equity finance and what elsewhere is deemed to be equity participation is much more akin to debt".

- 16/ This is not to deny that the transnational organisation of production is quite capable of bringing industrialisation to the less-advanced countries; but it is to deny that such transformations normally provide a catching-up mechanism for the less developed economies. The other centripetal forces which are endemic in the market system will normally ensure that this will not happen. Japan is the important case in point. It was only able to break out by acting decisively to constrain and redirect such forces as a matter of national policy.
- 17/ Of course this will remain an important requirement in the case of some less-advanced economies where access to foreign exchange is a major problem. Thus, in the case of Eastern Europe, import planning will remain crucially important.
- 18/ For this see, for example, Johnson (1982), Ozaki (1984) and Dore (1986).
- 19/ It is important to recognise that what is being proposed is not the Japanisation of the economy. The question of the organisation of work is not being addressed here. We are simply focusing on the relevance of the approach by the state to the question of industrial strategy.
- 20/ There are, of course, also some within the centrally planned economies who recognise that planning and the market may be appropriate, but this appears to mean that the detailed, centralised planning system is retained except where it has totally failed to deliver the goods. The central thrust of this



paper is that an overall planning system is required within a market economy for very positive reasons and the Japanese system, which avoids many of the pitfalls encountered in Eastern Europe offers the beginnings of a way forward.

- 21/ The experience of Eastern Europe would also be supportive of this. The lack of economic success, in term of efficient production and innovativeness, can certainly not be ascribed to any lack of size of enterprise. Giantism has not delivered the goods to the East and has revealed severe deficiencies in the West.
- 22/ Of course the reorganisation of production along the lines of flexible specialisation may take place internally within the existing giants, but this leaves their external dominance intact or even enhanced.

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