The Decline of the British Economy: An Institutional Perspective

BERNARD ELBAUM AND WILLIAM LAZONICK

This paper attributes the relative decline of the British economy in the twentieth century to rigidities in its economic and social institutions that had developed during the nineteenth-century era of relatively atomistic competition. Inherited and persistent constraints impeded British firms from acquiring the market control, authority in labor relations, or managerial hierarchy necessary to avail themselves fully of modern mass production methods. At the societal level there was an interrelated failure to transform the character of British educational and financial institutions, labor-management relations, and state policy in order to promote economic development. By performing better in these respects late-industrializing countries were able to surpass Britain in economic growth.

THE British economy, once the workshop of the world, seems to have fallen victim to some century-long affliction. For lack of an adequate generic diagnosis, many observers have termed this affliction the "British disease."[1] There are signs, however, that the disease may be spreading, and the recent competitive reverses of American industry in the face of Japanese and European challenges have sparked renewed interest in explanations of economic growth and decline. The Japanese success in particular has recently received most of the attention from economists and policy makers, but there is yet, we would argue, much to be learned from Britain's economic failure.

In Britain itself, the ideology directing current government policy assumes that the nation's decline has been due to the obstruction of the self-regulating market economy by trade union power and state intervention. This ideological perspective finds intellectual reinforcement in orthodox economic theory that, in both its liberal and conservative variants, views the capitalist economy as fundamentally an atomistic market economy. According to economic orthodoxy, the perfection of market competition and economic prosperity go hand in hand.

Although this proposition goes back to the time of Adam Smith, it has

Journal of Economic History, Vol. XLIV, No. 2 (June 1984). © The Economic History Association. All rights reserved. ISSN 0022-0507.

Bernard Elbaum is Assistant Professor of Economics, Boston University, Boston, Massachusetts 02215, and William Lazonick is Associate Professor of Economics, Harvard University, Cambridge, Massachusetts 02138. This paper synthesizes new research on British industrial decline, much of which will appear in a forthcoming Oxford University Press volume edited by Elbaum and Lazonick. They wish to thank the participants at the Anglo-American Conference on the Decline of the British Economy (held at Boston University on September 30-October 1, 1983) for their help in shaping the perspective presented here, and to Lance Davis and Michael Edelstein for their comments at the 1983 Economic History Association meetings.

[1] See, for example, G. C. Allen, *The British Disease* (London, 1976).

never been adequately supported by comparative examination of the historical experiences of capitalist economies. In particular, the issue of Britain's decline has largely been avoided by neoclassical economic historians who have been preoccupied with demonstrating that turn-of-the-century British managers "did the best they could" by optimizing subject to given constraints.[2] Neoclassical economists who have confronted the problem of explaining national decline simply assume that the mainspring of the wealth of nations is free market competition and proceed as a matter of course to blame Britain's economic misfortunes on either market imperfections or "noneconomic" factors such as the cultural peculiarities of businessmen or workers.[3]

By contrast, the historical perspective presented below attributes the decline of the British economy to the rigid persistence of economic and social institutions from the nineteenth-century era of relatively atomistic competition. In such countries as the United States, Germany, and Japan, successful twentieth-century economic development has been based on mass production methods and corporate forms of managerial coordination. But in Britain adoption of these modern technological and organizational innovations was impeded by inherited socioeconomic constraints at the levels of the enterprise, industry, and society. Entrenched institutional structures—including the structures of industrial relations, industrial organization, educational systems, financial intermediation, international trade, and state-enterprise relations—constrained the ability of individuals, groups, or corporate entities to transform the productive system.

Britain's problem was that economic decision makers, lacking the individual or collective means to alter prevailing institutional constraints, in effect took them as "given." In failing to confront institutional constraints, British businessmen can justifiably be accused of "entrepreneurial failure."[4] But the cause of the failure was not simply cultural conservatism, as some historians have implied. If British society was pervaded by conservative mores, it was in this respect certainly no worse off than Japan or continental European countries that were precapitalist, tradition-bound societies when Britain was the workshop of the world. The thesis of entrepreneurial failure casts no light on why Britain, the first industrial nation, should have been less

[2] Donald N. McCloskey, ed., *Essays on a Mature Economy: Britain After 1840* (London, 1971); Donald N. McCloskey and Lars Sandberg, "From Damnation to Redemption: Judgments on the Late Victorian Entrepreneur," *Explorations in Economic History*, 9 (Fall 1971), 89–108; R. C. Floud, "Britain 1860–1914: A Survey," and L. G. Sandberg, "The Entrepreneur and Technological Change," both in *The Economic History of Britain since 1700*, ed. Roderick Floud and Donald McCloskey, vol. 2 (Cambridge, 1981).

[3] See, for example, Richard E. Caves, "Productivity Differences among Industries," in *Britain's Economic Performance*, ed. Richard E. Caves and Lawrence B. Krause (Washington, D.C., 1980).

[4] David Landes, *The Unbound Prometheus* (Cambridge, 1969), chap. 5; Martin Wiener, *English Culture and The Decline of the Industrial Spirit, 1850–1980* (Cambridge, 1981).

successful than later industrializers in shedding customary attitudes that encumbered economic performance.

Britain's distinctiveness derived less from the conservatism of its cultural values per se than from a matrix of rigid institutional structures that reinforced these values and obstructed individualistic as well as concerted efforts at economic renovation. In our view, the causes and consequences of such institutional rigidities remain central to understanding the long-term dynamics of economic development as well as the current crisis of the British economy.

THE CONSEQUENCES OF COMPETITIVE CAPITALISM

In the third quarter of the nineteenth century, the British economy experienced a "long boom" that represented the culmination of the world's first industrial revolution. After three centuries of international conflict for the control of world markets and after seven decades of intense capital investment in productive capacity, Britain emerged unchallenged in the world economy. On the basis of national domination of world markets, there was much in the way of opportunity for aspiring merchants and manufacturers. As they entered into commerce and industry, the structure of British industry became extremely competitive. By today's standards, Britain's major nineteenth-century staple industries—textiles, iron and steel, coal mining, shipbuilding, and engineering—were all composed of numerous firms with small market shares. Their industrial structures were also characterized by a high degree of vertical specialization: distribution of intermediate and final products relied upon well-developed market mechanisms, often involving specialized merchant firms.

The managerial organization and technology employed by nineteenth-century British firms were comparatively simple. Characteristically, firms were run by owner-proprietors or close family associates. Managerial staffs were small, and methods of cost accounting and production control were crude or nonexistent. The development of industrial techniques typically relied upon trial and error rather than systematic in-house research. Most enterprises were single-plant firms that specialized in particular lines of manufacture of intermediate or final products. Industries exhibited a high degree of regional concentration based upon geographical advantages as well as external economies provided by local access to skilled labor supplies, transport facilities and distribution networks, capital, and product markets.

Up to the 1870s the long-term financing for these business ventures came from country banks, personal family fortunes, and retained earnings. After the collapse of the country banks in the Great Depression of the 1870s, financial institutions had little involvement in the long-

term finance of British industry. The purchasers of share capital tended instead to be individuals—among them many shopkeepers and skilled workers—who invested their savings locally. With British firms able to tap local as well as internal sources of long-term financing, there is no evidence that they were short of capital in the decades prior to World War I. The last decades of the nineteenth century also saw the extension of national banks and the development of a highly liquid national capital market. But industrial firms were reluctant to risk loss of control by issuing equity on the national market or incurring long-term debt. Financial institutions provided only short-term working capital to British industry (mainly through overdraft accounts), and as a result never developed the institutional expertise to serve the demand for long-term capital that did arise. Instead they exported most of their capital, usually in exchange for fixed-interest bonds, to finance large-scale (typically government-backed) foreign projects such as railroads. A consequence of these arrangements was the separation of provincial industrial enterprise from national financial institutions based in the City of London, a characteristic feature of the British economy well into the twentieth century.[5]

Another outcome of British capitalism as it developed in the last half of the nineteenth century was the consolidation of job control on the part of many groups of workers in industry. During the "long boom," individual capitalists, divided by competition, opted for collective accommodation with unions of skilled and strategically positioned workers rather than jeopardize the fortunes of their individual firms through industrial conflict while there were profits to be made. The labor movement also made important legislative gains that enhanced the ability of workers to organize unions, build up union treasuries, and stage successful strikes.

A distinguishing feature of the British labor movement was its two tiers of bargaining strength. Workplace organizations enjoyed substantial local autonomy in bargaining, backed by the leverage that national unions could exert on employers during disputes. From the fourth quarter of the nineteenth century, as intermittent but often prolonged recessions occurred and as foreign competition began to be felt by many industries, capitalists were unable to replace the job control of shop-floor union organizations by managerial control. Despite the introduction of many skill-displacing changes in technology, the power of the union organizations that had developed earlier had simply become too great. Attempts by Parliament and the judiciary to undermine the trade union movement—most notably by means of the Taff Vale decision—resulted in the emergence of a distinct political party representing the interests of labor.

[5] Michael Best and Jane Humphries, "The City and the Decline of British Industry," in *The Decline of the British Economy*, ed. Bernard Elbaum and William Lazonick (Oxford, forthcoming).

THE CHALLENGE OF CORPORATE CAPITALISM

Elsewhere, from the late nineteenth century (notably in Japan, Germany, and the United States) corporate capitalism was emerging to become the dominant mode of economic organization. Corporate capitalism was characterized by industrial oligopoly, hierarchical managerial bureaucracy, vertical integration of production and distribution, managerial control over the labor process, the integration of financial and industrial capital, and systematic research and development.[6]

Oligopoly, by helping to stabilize prices and market shares, facilitated long-run planning, particularly where large-scale capital investments were involved. Managerial coordination of product flows within the vertically integrated enterprise permitted the achievement of high-speed throughputs that reduced unit costs. Vertical integration of production and distribution provided the direct access to market outlets that was a precondition for the effective utilization of mass production methods. Managerial control over the labor process in turn facilitated the introduction of new, high-throughput technologies. Integration of financial and industrial capital, along with managerial bureaucracy, made possible the geographic mobility of capital and the rapid expansion of capacity to produce for new or growing markets. Systematic research and development, particularly in such science-based industries as electrical and chemical manufacturing, provided the mainspring of technological innovation. Across countries, the degree of coordination of economic activity by the state and large financial institutions varied, with significant implications for economic performance. But the experience of successful capitalist economies in the twentieth century demonstrates the ubiquitous importance of the visible hand of corporate bureaucratic management.

In order to compete against the corporate mass production methods being developed in Germany, Japan, and the United States, British industries required transformation of their structures of industrial relations, industrial organization, and enterprise management. Vested interests in the old structures, however, proved to be formidable (if not insurmountable) obstacles to the transition from competitive to corporate modes of organization. Lacking corporate management skills and opportunities, British industrialists clung to family control of their firms. Even where horizontal amalgamations did take place, the directors of the participating firms insisted on retaining operational autonomy.[7] In any case, very few of these managers had the broader

[6] Alfred D. Chandler, Jr., *The Visible Hand* (Cambridge, Massachusetts, 1977); Alfred D. Chandler, Jr., and Herman Daems, eds., *Managerial Hierarchies* (Cambridge, Massachusetts, 1980).

[7] Leslie Hannah, *The Rise of the Corporate Economy: The British Experience* (Baltimore, 1976); Alfred D. Chandler, Jr., "The Growth of the Transnational Industrial Firm in the United States and the United Kingdom: A Comparative Analysis," *Economic History Review*, 2nd ser., 33 (Aug. 1980).

entrepreneurial perspectives or skills needed to develop modern corporate structures.[8]

The British educational system hampered industry by failing to provide appropriately trained managerial and technical personnel. On the supply side, the existing system of higher education was designed almost explicitly to remove its "aristocratic" students as far as possible from the worldly pursuit of business and applied science.[9] On the demand side, there was comparatively little pressure to transform this system as highly competitive businesses could not afford to hire specialized technical personnel and were further reluctant to support industry-wide research institutes that would benefit competitors as much as themselves.[10] Given the lack of interest of business and the educational establishment in fostering managerial and technical training, it is not surprising that the British state, rather passive towards industrial development in any case, took little initiative to make education more relevant to economic development.

Nor was leadership for industrial transformation forthcoming from other sectors of the British economy. The financial sector kept its distance from direct involvement in industry, preferring instead to maintain its highly liquid position by means of portfolio investment, mostly abroad. The orientation of Britain's bankers towards liquidity and protection of the value of the pound sterling was reinforced by the undisputed position of the City of London as the financial center of the world. The concentration of banking in the City also gave rise to a relatively cohesive class of finance capitalists with much more concerted and coherent power over national policy than industrial capitalists, who were divided along enterprise, industry, and regional lines.

In the absence of a shift to corporate enterprise structure, British industrialists also had little incentive or ability to challenge the shop-floor control of trade union organizations. In the United States and Germany a critical factor in the development of high-throughput production was the ability of management to gain and maintain the right to manage the utilization of technology. In most of Britain's staple industries, by contrast, managers had lost much of this "right to manage," reducing their incentive to invest in costly mass production technologies on which they might not be able to achieve high enough throughputs to justify the capital outlays. During the first half of the twentieth century, British unionism was able to consolidate its positions of control at both the national and workplace levels, aided by the

[8] William Lazonick, "Industrial Organization and Technological Change: The Decline of the British Cotton Industry," *Business History Review*, 57 (Summer 1983), 195–236.

[9] Julia Wrigley, "Seeds of Decline: Technical Education and Industry in Britain," in *The Decline of the British Economy*.

[10] David Mowery, "British and American Industrial Research: A Comparison, 1900–1950," in *The Decline of the British Economy*.

growing strength of the Labour Party and the emergency conditions of two world wars.

Lacking the requisite degree of control over product and input markets, British managers confronted severe obstacles in adapting their enterprise structures to take advantage of new market opportunities. As a result, in the late nineteenth and early twentieth centuries firms continued for the most part to manufacture traditional products using traditional technologies.

How these firms structured production depended very much on the prospects for selling their output. Contrary to typical textbook theory, Britain's competitive firms did not as a rule assume that the market could absorb all the output they might produce at a given price. Indeed they produced few manufactures in anticipation of demand. Almost all production was to order, much of it for sale to merchants for distribution to far-flung international markets.

In the heyday of British worldwide economic dominance, these arrangements proved advantageous to British firms. Unlike many of their international competitors, who had access only to much more confining markets, Britain's international marketing structure meant that British firms could get enough orders of similar specifications to reap economies of long production runs, and had a large enough share in expanding markets to justify investment in (what were then) up-to-date and increasingly capital-intensive plant and equipment. But the tables were turned by the spread abroad of tariff barriers and indigenous industrialization. Because Britain had already industrialized, its domestic market for such staple commodities as textiles or steel rails had reached a point of at best moderate growth potential. Under these circumstances, British firms could not find at home a market that could match the dramatic rates of expansion of the foreign markets foreclosed to them. Indeed, given its dependence on international markets, British industry was severely constrained to keep its own domestic markets open to the products of foreign firms.

Taking advantage of their more secure and expansive domestic markets, foreign rivals, with more modern, capital-intensive technology, attained longer production runs and higher speeds of throughput than the British. By virtue of their reliance on the corporate form of organization—in particular on vertical integration of production with distribution and more concentrated market power—Britain's rivals were better able to rationalize the structure of orders and ensure themselves the market outlets required for mass production. From secure home bases these rivals also invaded market areas and product lines where the British should have been at no comparative disadvantage.

Forced to retreat from competition with mass production methods, British firms sought refuge in higher quality and more specialized

product lines where traditional craftsmanship and organization could still command a competitive edge—in spinning higher counts of yarn and weaving finer cloth, making sheets and plates of open hearth steel, and building unique one-off ships. Unfortunately for the British, in a world of expanding markets, the specialized product of the day all too often turned out to be the mass production item of tomorrow. The arrival of mass production methods and the pace and timing of decline varied among the major staple industries, with British shipbuilding, for example, still holding a commanding competitive position as late as World War II. But all eventually met a similar fate.[11]

INSTITUTIONAL RIGIDITY

From the standpoint of the neoclassical model of competition, these developments would lead one to expect a British response to competitive pressures that would imitate the organizational and technological innovations introduced abroad. In fact, the British only adapted patchwork improvements to their existing organizational and productive structure. Facing increasingly insecure markets and lacking the market control requisite for modern mass production, the British failed to make the organizational renovations that could have allowed them to escape competitive decline.

With the massive contractions of British market shares that occurred in the 1920s and early 1930s, firms in the troubled staple industries alternated between scrambling for any markets they could get and proposals for elimination of excess capacity and concentration of productive structure. In a period of contraction the market mechanism was anything but an efficient allocation mechanism, in part because existing firms remained in operation as long as they could hope for some positive return over variable costs, their proprietors living, so to speak, off their capital. Coordinated attempts to eliminate excess capacity were confounded by numerous conflicts of interest between owner-proprietors, outside stockholders, management groups, customers, banks and other creditors, and local union organizations. In particular the involvement of the national banks in the attempts to rationalize industry was aimed more at salvaging their individual financial positions than at developing a coherent plan for industry revitalization. In light of the failure to achieve coordination the rationalization programs that were implemented in the interwar period were half-hearted and of limited effectiveness.

During the interwar period and beyond, the rigid work rules of British

[11] Edward Lorenz and Frank Wilkinson, "Shipbuilding and British Economic Decline. 1880–1965"; Bernard Elbaum, "British Steel Industry Structure and Performance before World War I"; William Lazonick, "The Decline of the British Cotton Industry"; Stephen Tolliday, "Industry, Finance, and the State: Steel and Rationalization Policy"; all in *The Decline of the British Economy*.

unions remained an impediment to structural reorganization. Entrenched systems of piece-rate payment often led to higher wage earnings in more productive establishments, deterring firms from scrapping old capacity and investing in new. Union rules also limited management's freedom to alter manning levels and workloads, which in mechanical, labor-intensive industries such as textiles had particularly adverse effects on the prospective benefits of new technology.[12] In general, management could be sure that the unions would attempt to exact a high price for cooperation with any plans for reorganization that would upset established work and pay arrangements. On the other hand, amidst industrial decline the strong union preference for saving jobs even at low wage levels was an additional conservative influence on a generally unenterprising managerial class.

Given this institutional structure, Britain's staple industries were unable to rationalize on the basis of the profit motive. They relied too much—not too little—on the market mechanism. To be sure, there were some highly successful enterprises such as Imperial Chemical Industries and Unilever that emerged in new industries during the interwar period.[13] But in terms of our perspective on capitalist development, these firms are the exceptions that prove the rule: success was ultimately based on control over product and input markets and the ability to transform internal managerial and production structures to maintain control. Furthermore, even the new industries were not immune to the wider institutional environment. The slow growth of demand in new product market areas hampered the emergence of large firms and created a need for consolidation of industrial structure. In chemicals, fabricated metals, and electrical machinery, newly amalgamated firms suffered from a dearth of appropriately trained managerial personnel and, initially, experienced serious difficulties in overcoming vested interests and in establishing effective coordination of their enterprises. In automobile manufacturing, competitive performance was undermined after World War II by a long-established management strategy of using labor-intensive techniques that helped breed control of shop-floor activities by highly sectionalized union organizations.[14]

THE IMPACT ON GROWTH

If difficult to quantify precisely, the overall impact of these institutional rigidities on British economic performance was undoubtedly

[12] Lorenz and Wilkinson, "Shipbuilding and British Economic Decline," and Lazonick, "The Decline of the British Cotton Industry."

[13] William Reader, *Imperial Chemical Industries: A History*, 2 vols. (Oxford, 1972); Charles Wilson, *The History of Unilever: A Study of Economic Growth and Social Change*, 2 vols. (London, 1954), and *Unilever 1945–1965: Challenge and Response in the Post-War Industrial Revolution* (London, 1965).

[14] Wayne Lewchuk, "The British Motor Vehicle Industry: The Roots of Decline," in *The Decline of the British Economy*.

considerable. Throughout the pre-World War I years, the staple industries remained economically preponderant. According to the 1907 Census of Production, the largest of these industries—coal, iron and steel (including non-electrical machinery and railway equipment), textiles, and shipbuilding—alone made up roughly 50 percent of total net domestic industrial production and 70 percent of British exports. During the long boom of the third quarter of the nineteenth century there was a rapid increase in British output per head that drew important impetus from growth and technological advance in the staple industries.[15] Subsequently, from 1873 to 1913 a marked slowdown in aggregate productivity growth occurred, with some evidence that growth was particularly sluggish from the late 1890s to World War I.

Detailed industry-level evidence is useful for assessing the accuracy of the aggregate data and the reasons for the prewar productivity slowdown. British cotton enterprises, for example, did not reorganize the vertical structure of production in order to adopt more advanced technologies. Instead they chose to compete on the basis of traditional organization and techniques by cutting raw material costs and intensifying workloads.[16] The resultant cost-savings, augmented by the benefits of well-developed external economies, enabled the cotton industry to expand its output and exports despite stagnating labor productivity in the 15 years or so before World War I. In the British steel industry there was significant ongoing productivity advance in the newer sectors of open hearth steelmaking. Bessemer practice, however, was comparatively stagnant after 1890 as firms were deterred from investing in new, large-scale facilities by a sluggish domestic market, overseas protection, an increasing threat from foreign imports, and fragmented industrial structure.[17]

British growth in output per head not only slowed in the last quarter of the nineteenth century, but also began to lag relative to latter-day industrializing economies that were developing the institutional bases for corporate capitalism. British growth rates first fell behind those of other countries in the 1870s and 1880s. Serious losses in international competition were first sustained between 1899 and 1913 and were interlinked with the failure of British industry to match the productivity advances achieved abroad by fully availing itself of the benefits of mass production methods. With the exception of wartime intervals, the gap in relative productivity growth performance between Britain and most of its competitors has remained substantial ever since.

During the interwar period the competitive weaknesses of the staple

[15] R. C. O. Matthews, C. H. Feinstein, and J. C. Odling-Smee, *British Economic Growth, 1856–1973* (Stanford, 1982), p. 26.

[16] William Lazonick and William Mass, "The Performance of the British Cotton Industry, 1870–1913," *Research in Economic History*, 9 (Spring 1984).

[17] Elbaum, "British Steel Industry Structure and Performance."

industries became evident, while the productivity performance of the British economy as a whole remained poor by international standards. There remains, however, considerable controversy over the connection between the performance of the staple industries and that of the aggregate economy. According to one influential perspective, the weak performance of the interwar economy was largely due to the relative lack of mobility of resources from the "old" to the "new" industries.[18] This argument, however, is open to criticism on several grounds. It assumes that the old industries imposed effective supply constraints on the growth of the new—a rather dubious proposition given the high unemployment levels, ongoing capital export, and the housing boom that characterized the interwar period. If there were supply constraints on the growth of the new industries it was because of the failure of financial and educational institutions to infuse industry with sufficient long-term venture capital and the types of personnel required.

This argument also implies that the basic problem of the British economy was one of structural adjustment out of industries in which comparative advantage had been lost and possibilities for technical advance had for the most part been exhausted. Yet there is little evidence that shifts in comparative advantage were the root of the competitive problems of Britain's staple industries. Some international competitors in these industries, facing prices for labor and resources greater than or equal to the British, were nonetheless more successful because they adopted major technical advances. Recent evidence also indicates that interwar productivity gains in Britain's staple industries were comparable to those in the new industries (although much of the measured gains in productivity reflect the closure of obsolescent capacity).

The staple industries contributed significantly to Britain's relatively poor interwar growth performance mainly because they still bulked large in the economy and lagged behind seriously in international standards of technological and managerial practice. In 1924 staple manufacturing industries still accounted for 45 percent of all manufacturing net output. By 1935 this figure had fallen to 35 percent but remained at roughly that proportion into the late 1940s.[19] With persistent excess capacity in the staple industries, firms that had long ago written off their plant and equipment always stood ready to "ruin the market" for firms that might otherwise have invested in the modernization of plant and equipment and enterprise structure. Divided by competition, the firms of Britain's staple industries were unable on their own to rationalize capacity.

[18] Derek H. Aldcroft and H. W. Richardson, *The British Economy, 1870–1939* (London, 1969).

[19] G. N. von Tunzelmann, "Structural Change and Leading Sectors in British Manufacturing, 1907–1968," in *Economics in the Long View*, ed. Charles P. Kindleberger and Guido di Tella (New York, 1982), vol. 3, pp. 28–30.

THE BARELY VISIBLE HAND

What British industry in general required was the visible hand of coordinated control, not the invisible hand of the self-regulating market. Given the absence of leadership from within private industry, increasing pressure fell upon the state to try to fill the gap. Even before World War I, calls were made for greater state intervention. By the interwar period the British state had assumed a distinctly more prominent role in industrial affairs, macroeconomic regulation, and provision of social and welfare services.[20]

With further growth of state intervention after World War II—extending to nationalization of industry and aggregate demand management—critics have pointed accusing fingers at the government for failing to reverse, and even for causing, relative economic decline. At various times and from various quarters the state has been blamed for undermining private-sector incentives and the natural regenerative processes of the free market economy, for absorbing resources that would have been employed more productively in manufacturing, or for failing to provide British industry with a needed environment of macroeconomic stability and a competitively valued exchange rate.

In historical perspective, however, state activism must be absolved from bearing primary responsibility for Britain's relatively poor economic performance. In the late nineteenth century, at the outset of relative decline, the most singular features of the British state were its small size and laissez-faire policies. Even in the post-World War II period, British levels of government taxes, expenditures, and employment were not particularly high by European standards. Indeed, a distinctive feature of British state policy throughout recent history has been its reluctance to break from laissez-faire traditions. It is only in the second instance that state policy is implicated in British decline, by virtue of its failure to intervene in the economy more decisively in order to take corrective measures. The consequences of this failure of state policy first became evident in the interwar period.[21]

THE LIMITS OF INTERWAR INTERVENTION

The Irrationalities of Rationalization Policy

State intervention between the wars included programs aimed at rationalizing the depressed staple industries in order to rid them of excess capacity and facilitate modernization. The problem of excess capacity had been exacerbated by the vast and imprudent expansion of

[20] Charles Feinstein, ed., *The Managed Economy* (Oxford, 1983).
[21] Peter Hall, "The State and Economic Decline in Britain," in *The Decline of the British Economy*.

investment and overdraft borrowing during the short but frenetic boom of 1920/21. The prolonged state of depressed trade that followed in the 1920s placed the banks' loans in serious jeopardy. At that time the Labour government was also considering direct intervention as a means of reorganizing the failing industries and alleviating industrial depression. This combination of circumstances prompted the Bank of England to step in.

For the Bank, rationalization was an economically viable and politically desirable alternative to more far-reaching forms of government intervention that threatened to go as far as nationalization and "encroaching socialism." Bank of England Governor Montagu Norman conceived of intervention as limited, temporary, and exceptional. The Bank's approach was highly consensual and "quasi-corporatist." Firms were encouraged to form trade associations and develop their own plans for industry rationalization. Within the trade associations, firms were authorized to negotiate common pricing policies, mergers, and production quotas. Even then individual firms were reluctant to have the Bank of England intervene, and it was only the stick of bankruptcy and the carrot of support for tariff protection that enabled it to do so.[22]

When the Bank intervened more directly, it was as a merger promoter rather than as an investment bank. Where the market did not respond, the Bank was unwilling to put up its own funds. With the Bank and Treasury allied in keeping a tight hold on the public purse strings, the public funds devoted to backing rationalization schemes were negligible. Yet the Bank found that its efforts at voluntary persuasion had little influence over the allocation of market sources of finance.[23]

As for the government, its interwar industrial policies were confined largely to monitoring industrial affairs through the Import Duties Advisory Committee, established under the 1932 tariff legislation, and to legislative schemes aimed at reducing excess capacity in industries such as textiles. Like the Bank of England, the Advisory Committee pursued influence through conciliation and suasion, seeking no powers of centralized control over industry. Lacking the requisite authority to shape industrial development, the committee found itself overseeing a process of industrial quasi-cartellization that ensured profits for weak and strong firms alike. Government legislation generally responded to the wishes of industry trade associations with similar results.

Public attempts at rationalization left British industry with the worst aspects of both competitive and monopolistic worlds. Productive structure remained highly fragmented and inefficient, while quasi-cartellization and tariff barriers (or imperial preference) protected existing producers from competitive pressure. Rather than achieving its objec-

[22] Best and Humphries, "The City and the Decline of British Industry"; Lazonick, "The Decline of the British Cotton Industry"; Tolliday, "Industry, Finance, and the State."
[23] Tolliday, "Industry, Finance, and the State."

tive of promoting industry rationalization, interwar policy inadvertently reinforced preexisting institutional rigidities.

The Underdevelopment of Industrial Research

State policy initiatives in the area of research and development originated at the onset of World War I with concern over the inability of British industry to supply technologically sophisticated materials of strategic military importance. Major policy initiatives included the establishment of a state-owned corporation (British Dyestuffs) and state-subsidized industrial research associations for the promotion of cooperative research and development by firms in the private sector. British Dyestuffs, however, was handicapped by a lack of trained chemists in top management positions and a reliance on chairs in universities for research efforts.

Government promotion of industrial research associations reflected a concern that few firms in Britain were large enough to undertake their own in-house research and development programs. As many as 24 Research Associations were established in industries ranging from woolen textiles to laundering. But firms often lacked the in-house technical expertise required to evaluate and employ the results of extramural research. As a result, Research Associations failed to gather the anticipated financial support from the private sector, and their impact on innovative performance was modest. Government-sponsored cooperative research proved to be an inadequate replacement for the in-house research capabilities of modern corporations.[24]

The Ruin of the Regions

Industrial decline in the interwar period created severe problems of regional unemployment and decaying infrastructure because of the high degree of local concentration of the staple industries. Interwar regional policies were, however, a limited and ad hoc response to diverse political pressures for regional aid, rather than a coherent attempt to deal with the social costs and benefits of relocation of economic activity. The most consistent element in regional policy was the reluctance of the government to become directly involved in industrial development. Instead, the state sought to alleviate regional disparities by policies directed towards improving the operation of labor and capital markets.

The effectiveness of these policies was constrained by macroeconomic conditions, the limited size of the programs, and the underlying assumption that facilitating the operation of market mechanisms would suffice to combat regional problems. Initially, the government promoted labor transference by providing assistance for individual workers or

[24] Mowery, "British and American Industrial Research."

households to move to more prosperous regions. But the unemployed workers in the depressed regions were mainly adult males, who were heavily unionized, whereas many of the expanding industries sought primarily new entrants to the labor force, particularly women and juveniles.

By 1937 the emphasis had shifted to moving jobs to unemployed workers by providing businesses with special sources of finance and subsidized factory rentals. Provision of capital to firms in the depressed areas, however, could not overcome the limits on investment demand posed by depressed regional markets. Nor could it overcome the inability of the single-industry family firms that predominated in interwar Britain to manage diversified industrial and regional operations. Expanding industries, which had already begun to develop in the South prior to the stagnation of the 1920s, continued to grow in these more prosperous areas during the interwar period.[25]

The Protection of the Pound

Following the lead of Keynes, a long line of economists have argued that interwar macroeconomic policies had seriously adverse effects on the British economy. A contrast is often drawn between the industrial depression of the 1920s, when restrictive policies preceded the 1925 resumption of the gold standard at the prewar parity, and the relatively strong performance of the economy in the 1930s, when devaluation and protectionism were forced upon the government. Yet if the deflationary impact of the macroeconomic policies of the 1920s seems beyond dispute, there has been a lively debate about its significance for the trend in growth of output per head. Detailed examination of the staple industries, which were the most seriously affected by the 1920s depression, indicates that slack domestic demand, intensified international competitive pressure, and high interest rates *exacerbated* rather than caused problems of excess capacity, shrinking profit margins, and a heavy debt burden. The problems of the staple industries were structural and long-term in character, and if dramatized during the low waters of recession, were also an increasingly evident undertow during the high tides of prosperity before and after the interwar period.

THE LEGACY OF HISTORY

The British economy of the post-World War II period inherited a legacy of major industries too troubled to survive the renewed onslaught of international competition that began in the 1950s. As competitive pressure mounted, the state began to nationalize industries such as coal,

[25] Carol Heim, "Regional Development and National Decline: The Evolution of Regional Policy in Interwar Britain," in *The Decline of the British Economy.*

steel, and automobiles that were deemed of strategic importance to the nation, and (with the exception of steel in 1951) that were in imminent danger of collapse. But nationalization, however necessary, was by no means a sufficient response to Britain's long-run economic decline. Public ownership overcame the problem of horizontally fragmented private ownership, but not inherited problems of enterprise productive structure, managerial organization, and union job control. Nationalized enterprises still had to confront these problems while attempting to overcome the technological leads already established by competitors.

Although the British government was called upon willy-nilly to play an increased role in industrial affairs, the basic theoretical and ideological framework guiding public policy has remained that of the self-regulating market economy. The rise of Keynesianism has led to widespread acceptance of interventionist fiscal and monetary policies, but for the most part has left unchallenged the neoclassical belief in the inherent dynamism of unfettered market competition.

The monetarist policies of the Thatcher government have taken the neoclassical perspective to its extreme. Invoking laissez faire ideology, Thatcher has attacked the power of the unions and sought revival through the severity of market discipline. But the supposition that there are forces latent in Britain's "free market" economy that will return the nation to prosperity finds little confirmation in historical experience. The only foundation for the free-market perspective appears to be the tradition of orthodox economic theory itself.

There is considerable irony in the neoclassical focus on free market competition as the engine of economic dynamism. The focus derives from the fundamental assumption of neoclassical theory that firms are subordinate to markets. History suggests, however, that successful development in the twentieth century has been achieved by markets being made subordinate to firms. The main thrust of the perspective presented here is that the British economy failed to make a successful transition to corporate capitalism in the twentieth century precisely because of the very highly developed market organization of the economy that had evolved when it was the first and foremost industrial nation.

By now, Britain's relative economic decline has persisted through enough ups and downs in the business cycle to indicate that its roots lie deeper than inappropriate macroeconomic policies. If contemporary economic discussion nonetheless is usually preoccupied with obtaining the right monetary and fiscal policies, it is because there has been comparatively little criticism of the microfoundations of neoclassical theory and related versions of laissez faire ideology. Despite the prominence of mass production methods in corporate economies, conventional economic theory has failed to analyze the associated

developmental process of productivity growth and technological change.

If existing institutional arrangements seriously constrained the actions of individual British industrialists and rendered impotent intervention by the state, the example of late-developing nations suggests that a purposive national program can enjoy considerable success in adapting institutions to meet growth objectives. The task for political economy is to identify those elements of the prevailing institutional structure that will promote and those that will hinder alternative strategies of socioeconomic development. The argument presented here contends that planning at the levels of the enterprise, financial institutions, and the state has become increasingly important for international competitiveness and economic growth, even within the so-called market economies. To elaborate and modify this perspective will require historical studies of the interaction of planning and market forces in economic activity and the resultant impact on performance. Thus far we have only begun to research this perspective, and to test the various hypotheses generated by it. But we view the synthesis presented here, as well as the research upon which it is based, as important foundations for understanding modern economic development.