



# AMICUS — The future of manufacturing





# Foreword

by Derek Simpson, General Secretary, Amicus, September 2006

Two years ago, I introduced “The Manufacturing Agenda”, a document which set out our aspirations for manufacturing in the UK. Since then a further 200,000 jobs have been lost from the sectors which make up the UK manufacturing picture.

Yet at the same time we have continued to see growth in the economy, low inflation, stable interest rates and moderate wage increases. You have to ask yourself the question – is there a future for manufacturing? The answer is a resounding YES, and this detailed research document, produced by Amicus, explains the issues that have to be tackled, describes the scene as it is now and offers a strategy built upon the policies that members have determined through sector and national policy conferences.

It is disappointing that two years on from the publication of our manufacturing agenda and the government’s own review of its manufacturing strategy, the sector is still struggling. Job losses in traditional areas such as the motor industry have not been replaced in the new manufacturing world described by government as populated by high skilled and high added value jobs. Work continues to be sent offshore to low wage cost areas driven by the short term interests of investors to increase their returns. But the picture is not all doom and gloom.

As this document shows, the UK is attracting more investment from overseas than the US. Government has committed billions to encourage research and development and innovation and is ploughing significant funds into promoting and delivering a higher skilled workforce. But we are questioning whether this money is being well directed. And we are asking the questions about the contribution that employers are making, both financially and strategically.

The evidence brought together in “The Future of Manufacturing” challenges the myth that the flexible labour market is delivering the skills and investment that manufacturing needs in the UK. Government support for manufacturing cannot be left to fine words of encouragement to UK industries. We need a government that treasures manufacturing as other European states do. We need a government that is prepared to invest directly in UK workers by adopting a positive procurement policy. What we do not need is a government that blindly embraces the market and unrestricted globalisation with the poverty and insecurity that accompanies it, and abandons the quest for social justice and equality.

There is a future for manufacturing in the UK. What is equally clear is that there is no future for the UK without manufacturing. I commend this document to you and commit Amicus to continuing the fight for the future of manufacturing in the UK.



Derek Simpson



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# The manufacturing economy



# Introduction

Two years ago Amicus published a Manufacturing Agenda for the UK in which it highlighted key issues essential to a successful strategy for manufacturing in the UK. Much of what is contained in that document remains relevant to the current situation facing manufacturing in the UK.

In the last two years the haemorrhaging of jobs from the sector has continued at an alarming rate. In May 2004 employment in manufacturing stood at 3.263 million. Two years on in May 2006 that figure has dropped to 3.046 million **(1)**, a loss of 217,000 jobs. If this rate of job loss were to continue unabated, manufacturing in the UK would cease to exist in 2035.

In the chapters that follow, Amicus analyses the factors which will impact upon manufacturing in the UK and examines possible outcomes and courses of action necessary to ensure that there is a future for manufacturing in the UK. The document looks at the UK economy as well as changes which are happening world wide. In particular, it examines the global impact of ownership of industry in the UK and what this means for job security and working conditions.

The shift of the manufacturing base globally is a crucial part of understanding the control of manufacturing investment and this document examines the key factors which determine the location of industries. As well as looking at the much reported impact of China in terms of manufacturing, a wider perspective is drawn from an analysis of the BRIC economies (Brazil, India, Russia and China) and the impact of the accession states in the EU.

Turning to the relative position of the UK in this global

economy, the document revisits the working conditions and employment protection afforded to UK workers compared to their EU counterparts. Recent evidence **(2)** will be examined which shows that the flexible labour market advocated so strongly by the UK government is not the only show in town when it comes to achieving economic growth and stability.

The government's own strategy for manufacturing is examined and in particular the approach to skills and training. In recognising the significant emphasis placed on this issue by all stakeholders, the document examines the evidence of what progress is being made to deliver the skilled workforce needed and whether the commitments made are being translated into practical reality.

Government can play a direct part in supporting manufacturing through state aid and procurement policies. This is an area where much still needs to be done to create the level playing field on which UK based manufacturers are offered the same support as employers elsewhere in Europe. The document looks at the disparities which currently exist and poses suggestions for improvement.

Amicus remains committed to the promotion of UK manufacturing as a means of ensuring that the overall economy of the UK maintains stability and the ability to create wealth for the benefit of the population as a whole. The document concludes with a summary of the main building blocks upon which the ongoing campaign to defend manufacturing jobs and promote the growth of a sustainable manufacturing sector for the future can be built.

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*(1) ONS Labour Market Trends 2006*

*(2) Boosting Jobs and Incomes – Policy lessons from reassessing the OECD Jobs Strategy © OECD 2006*

# The manufacturing economy

## **BACKGROUND**

The outcome of the economic performance of the current government over the last 9 years has made relatively impressive reading up until recently in broad terms but nevertheless hides the underlying misery that many workers in the UK have had to face during that period. The second half of 2006 has not started well and cracks in the overall economy are starting to show.

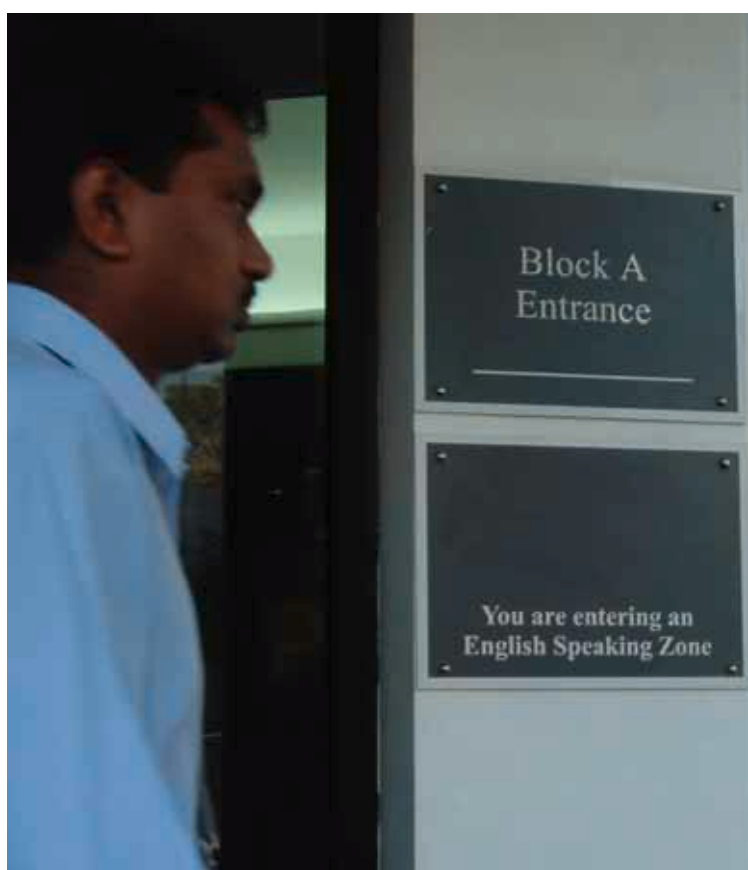
Unemployment has been rising for a number of months, interest rates have been increased for the first time in 2 years in August 2006, and inflation is running at levels above the government's target. Add to this the highest ever levels of debt, record numbers of bankruptcies and the lowest level of personal savings and it is difficult to reconcile the picture of a "stable economy" painted by government to the reality for many people.

The UK economic record in manufacturing is even gloomier. Manufacturing employment levels are half those when Labour came to power in 1997 with employment figures in May 2006 of just over 3 million. The sector's share of GDP has fallen from 23% in 1979 to 15% in 2005. However, seen in context, the gross value added in manufacturing in 2005 was £148 billion, almost 20% higher than in 1979. Manufacturing currently generates around £147 billion of exports revenue a year, around 60% of total exports of goods and services.

In relative terms UK manufacturing has grown more slowly than that of other developed economies over the past 25 years with the USA, Japan and Western Europe all outperforming the UK. The UK's decline in the manufacturing share of GDP is swollen by the outsourcing of service functions within industry such as accounting and delivery services. When these activities were part of manufacturing business they were defined as manufacturing activities. Once outsourced to service companies they were recorded as part of the service sector. This may have exaggerated the fall in manufacturing by as much as 20%.

It is also true to state that the performance of UK manufacturing varies considerably across sectors. Whilst labour intensive sectors such as textiles have declined significantly, sectors such as pharmaceuticals and aerospace have seen high growth.

The UK manufacturing economy is heavily dependent upon overseas trade and the growth of other "new" industrialised economies, described later in this publication, is a significant factor in the current decline of manufacturing. The globalisation of the manufacturing economy has meant that job location is increasingly driven by wage costs and this has been exacerbated by the recent introduction of the accession states into the EU. It is ironic that shareholders in the developed economies, such as the UK pension funds, benefit from multinationals increasingly relocating production, transferring technology and sourcing from low-cost economies, whilst workers in the same economies see the export of jobs as the price to be paid for increased shareholders' income.



## EXCHANGE RATES

Over the last 10 years the UK has seen a 30% rise in the exchange rate of the pound. Albeit this was from a relatively low base but it has now remained at a high level for some time. The adverse impact of high exchange rates on the ability of manufacturing companies to export is one of a number of factors currently having a negative affect on the manufacturing economy in the UK.

Following a slight upturn in output in the first quarter of 2006, latest figures for the manufacturing sector show a marginal output growth of only 0.1 per cent between May and June 2006 (3). The figure was dragged lower by a 1.3 per cent decrease in output in chemicals and man-made fibres industries. As forecasts for global growth remain subdued any further increase in interest rates would hit a UK manufacturing sector reliant upon investment and exports particularly hard.

Conversely, with a high valued currency the UK has been importing very large volumes of manufactured goods in a spending boom which has been financed by the sale of capital assets to foreign buyers and by consumer borrowing. This process is like selling the family silver - and much of the family estate - to pay for current consumption and then borrowing to allow further consumption. The inflow of capital from the asset sales to foreign investors keeps up the exchange rate (the value of the pound) in the short term so that goods from abroad are kept artificially cheap and levels of imports are kept artificially high. In other words the asset sales don't just help to give us the money to spend on imports but, through this exchange rate mechanism, they actually make imported goods cheaper. The prices of imported manufactured goods have also been dropping because of the liberalisation of the world economy and the emergence of the low-cost BRIC countries (Brazil, Russia, India and, most importantly, China). Lower prices have fuelled an appetite for imports and in most product categories the UK could not produce substitutes at anything like the imported prices, if at all.

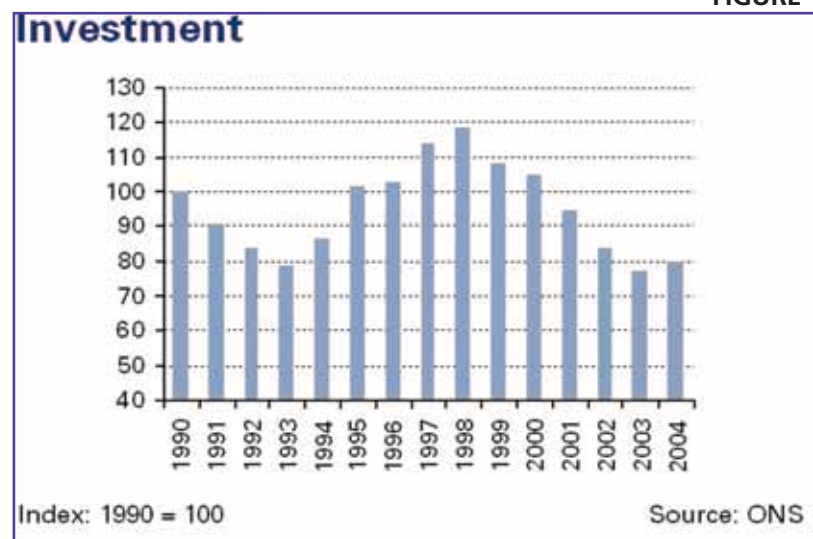
(3) ONS Industrial production figures August 2006

## INVESTMENT

A flavour of the level of foreign investment in the UK is given in the later chapter on foreign investment but in economic terms it is worth mentioning here that the statistics presented by government showing an increase in share ownership from overseas of some 33% at the end of 2004 compared to 7% in 1963 is somewhat understated since many of the acquisitions have ceased to be quoted on the UK market and the 33% is only a proportion of those companies that have survived. OECD figures released on 28th June 2006 showed that for 2005 the UK drew in \$164 billion of direct investment whereas even the much larger US economy only drew in \$110 of foreign investment.

All of this is contributing to an economic climate that is less and less helpful to the manufacturing sector. As a sign of the Monetary Policy Committee's concerns in August 2006 an increase in the interest rate of 0.25% was designed to dampen down the spending bonanza. For manufacturing however, it also dampens down the enthusiasm for investment, a crucial element to the recovery of the sector's fortunes. As Figure 1 below shows the relative levels since 1990 of UK manufacturing investment has not been good. One of the five pillars identified by government in its Manufacturing Strategy Action plan in 2004 was investment. Specific measures had been put in place to encourage investment, such as R & D tax credits and the maintenance of a stable macro-economic climate, but the manufacturing sector's investment performance is still very low.

FIGURE 1



In 2004, manufacturing investment rose by 2.5 per cent – its first annual rise since 1998. However, investment remains at historically low levels. In the first three quarters of 2005 manufacturing investment levels were erratic.

It is generally acknowledged that UK manufacturing has suffered from years of under-investment. Table 1 below shows this decline between 2001 and 2004 (4).

**TABLE 1**

<b>Manufacturing Investment (£ million)</b>			
<b>Year</b>	<b>Total manufacturing investment</b>	<b>Total business investment</b>	<b>Manufacturing as percentage of total investment</b>
2001	16,462	111,902	14.7
2002	13,807	110,166	12.5
2003	13,381	106,813	12.5
2004	13,641	110,670	12.3

It is no coincidence that this poor investment performance in the UK manufacturing sector reflects the under performance in terms of productivity, and it raises questions about the global ownership of UK manufacturing, and the decision making process and control of investment decisions in UK plants.

This is another factor which is covered more fully in later chapters.

#### **ENERGY PRICES**

A further negative element which has impacted to the detriment of manufacturing has been the recent surge in energy prices brought about by the past errors of creating a dash for gas resulting in the depletion of UK stocks to such an extent that we are no longer self sufficient in gas and have to depend on imports. The situation has been further complicated by the UK liberalisation policy for energy supplies in advance of the rest of Europe resulting in market price manipulation to the advantage of the suppliers and to the detriment of intensive industrial

users. Whilst the government has been sympathetic to Amicus and trade union concerns on this issue it remains to be seen whether the minimal actions taken to address the immediate problems envisaged for the Winter 2006/07 will be sufficient to avoid the potential loss of jobs that may ensue if energy costs become unsustainable. This factor will also influence investment decisions by global companies for the next 5 years.

#### **PRODUCTIVITY**

For the UK manufacturing economy to regain a sustainable position in the world market overall productivity levels need to be improved. Much has been written in recent years about the relatively poor productivity performance of UK manufacturing and although recent growth in productivity rates in the UK compares favourably with most European competitors, overall productivity remains significantly lower than in France, Germany and the US.

**FIGURE 2**



#### **FUTURE PREDICTIONS**

If the UK economy is to respond to the needs of the manufacturing sector, the government will need to address a number of economic issues. On the current performance of the economy and the sector, the forecast remains bleak. Table 2 gives an outlook which would see a continuance of the annual loss of over 100,000 jobs from the sector into 2007.

TABLE 2

<b>Economic forecasts for the manufacturing sector (percentage change except where stated)</b>					
	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>
Output - engineering	0.3	4.2	0.0	2.5	2.3
Output - manufacturing	0.1	1.9	-0.6	0.8	1.2
GDP	2.5	3.2	2.0	2.4	2.8
Employment - engineering (000s)	1,443	1,379	1,350	1,305	1,265
Employment - manufacturing (000s)	3,317	3,187	3,100	2,983	2,883

*Engineering Employers Federation Dec 2005*

Amicus will highlight in the remaining chapters of this document a series of steps needed to be taken to ensure a brighter future for the manufacturing sector. As far as the economy is concerned it is clear that further increases in interest rates will severely damage the sector and hamper any sustained recovery. Government also needs to act to counter further inflationary pressures on energy prices which discourage immediate and long term investment in the sector and to address the problems created by the high value of sterling.

Without a basic economic strategy which reflects and understands the needs of manufacturing other strategies commended by government and the Manufacturing Forum (5) will fail to deliver a sustainable future for manufacturing.

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(5) *The Forum brings together government, industry, trade unions, Regional Development Agencies, and other stakeholders to support manufacturing*

A photograph showing a group of business professionals in a meeting. They are all looking towards the left side of the frame. The individuals are dressed in formal business attire, including suits and blouses. The background is slightly blurred, suggesting an indoor setting like a conference room or a meeting hall. The lighting is soft and even.

# Foreign Investment and ownership in the UK

# Foreign Investment and ownership in the UK

## INTRODUCTION

Foreign direct investment (FDI) is consistently recognised as a significant driving force in encouraging long-term economic development. In addition to injecting capital, FDI has the potential to create jobs, encourage technological innovation, enhance export activity and ultimately raise productivity levels. FDI is seen by most economists as essential for the competitiveness of nations within the global economy.

However, there are also perceived downsides to FDI. These include a possible conflict between transnational corporations (TNC's) and nation states, risks to the domestic economy especially around mergers and acquisitions, risks to the political, social and cultural fabric of the host nation, and an increasing move to protectionist strategies around defence and security after 9/11.

The clearest definition of a foreign direct investor is an entity that has a direct investment enterprise operating in a country other than the economy of residence of the foreign direct investor. The investor could be an individual, a government, estates, trusts or organisations that own enterprises. Direct investment is a type of cross-border investment that is made by a resident entity in one economy with the object of establishing a lasting interest in an enterprise located in an economy other than that of the investor (6). There are two main forms of FDI, 'greenfield', whereby a company establishes a whole new operation in a foreign country, or by a merger or acquisition of an existing company.

Foreign Direct Investment is an important source of capital for nation states but has particular significance for developing countries. To this end, the structures within the developing country need to be in a position whereby they can accept substantial amounts of FDI and be able to ensure that the investment benefits the greatest number of recipients. To enable developing countries to do this it

is recommended that they adopt Policy Instruments (PI). These are the regulations which a developing country will need to manage the power and autonomy of huge transnational corporations. The policy framework is a crucial part of the overall strategy for industrialisation and the role of policy instruments cannot be overestimated. Policy instruments are the measure that will ensure the economic well-being of a developing country and encourage future industrial development and prosperity.

## GLOBAL OVERVIEW

2005 proved to be an exceptional year for FDI across many of the world's economies. The UK usurped the US position at the head of the table for inward FDI with an inflow of \$165 billion (7). This is the largest inward direct investment ever recorded in the UK, representing an increase of triple that of the 2004 figure. The US had an 18% decrease in inward investment in 2005, a level which is significantly lower than the levels of investment recorded for 2000. The UK continues to be the nation of choice for many foreign inward investors. This is due to a number of significant factors but in the main is down to the flexibility, stability and conservatism of the state, economy and workforce. It also reflects that the UK is home to many of the largest transnational corporations

The US lost its position as the most significant outward investor in 2005. This role was assumed by France and came about because of a number of significant acquisitions abroad. Substantial investment continued in the economies of Asia, and to a lesser degree Russia, but the most significant recipient of inward investment was China. The Chinese economy continues to grow at an official rate of 10% (8), a rate that is almost certainly an underestimation due to accounting procedures in China. It should also be noted that in China there has been a shift away from inward investment in manufacturing and a move towards the service sectors. In 2005, the banking, insurance and securities sectors are estimated to have received inward investments of \$12 billion (9).

(6) *OECD-Trends and Recent Development in Foreign Direct Investments, p6*

(7) *Ibid, p3*

(8) *Ibid, p1*

(9) *Ibid, p9*

The Indian economy also enjoys investment levels close to that of China and has seen significant 'bedding down' of inward investment and a future commitment from investors for further development of internal I.T. and telecommunications industries, for example the five largest software companies in India are domestically owned (10). In 2005 inward investment was \$6.5 billion. Again, this is likely to be an underestimation due to liberalisation measures ensuring that most inward investments enter India unscreened, requiring only notification to the central bank – an obligation that is not enforced. The general view of India as a country enjoying the benefits of outsourcing and off-shoring of call centres and IT industries from other nation states, does not give a true picture of what is currently happening. For example, two sectors that also received considerable amounts of FDI were automobile manufacture and mining.

For our European neighbours, France enjoyed more than double the FDI in 2005 than in 2004, \$64 billion and \$31 billion respectively. The significant factor with France is the acquisition of corporate and residential property and land by foreign investors, notwithstanding the fact that over the past 6-8 years France has rigorously pursued a strategy of acquisitions in other European economies. France gained on the US by becoming the world's largest outward investor in 2005. This is due to a number of very large mergers and acquisitions, for example Allied Domecq. In the case of Germany, FDI and outflow investment remained stable and did not show any dynamic growth over previous years. However, it is interesting to note that there was a significant disinvestment of German owned assets in the US (11).



TABLE 3

Industrial				
Company	Home Economy	Industry	Sales (£millions)	Employees
Eastman Kodak Co	United States	Chemicals	13 406	N/A
Perstorp Chemitac Ltd	Sweden	Textiles and Leather	10.352	80
Ford Automotive	United States	Motor Vehicles	8 048	35 000
IBM UK Holdings	United States	Electrical and Electronic	5 901	17 800
Kvaerner plc	Norway	Diversified	3 379	29 818
Matsushita Electric	Japan	Motor Vehicles	3 379	3 554
Arjo Wiggins Appleton	Italy	Paper	3 365	19 000
Honda Motor Co	Japan	Motor Vehicles	2 925	3 833
Peugeot Motor Co	France	Motor Vehicles	2 639	5 267
Totalfinaelf	France	Petroleum	2 620	13 419

**UNCTAD WID Country Profile: United Kingdom**

(10) *World Investment Report 2004*, p.250 citing Latif and Taylor (1999)

(11) *Deutsche Bundesbank, Monatsbericht, March 2006*.

## **MERGERS AND ACQUISITIONS**

While mergers and acquisitions (M&A) are only one element of FDI, in many countries M&A accounts for more than half of total direct investment. In the first 5 months of 2006 total outward M&As totalled \$217 billion and total inward M&As were \$213 billion **(12)**. If these figures are indicative of the rest of 2006 they will represent a slight decline on M&As in 2005 but will still be relatively high compared with other years. The two biggest recipients of M&As are the UK and the US who received 21 cross-border takeovers of large organisations between them.

In the US defence industry, one takeover generated considerable public interest in 2005. This was the acquisition of United Defence Industries for \$4 billion by BAE Industries in the UK. Another large takeover was of International Steel Group by Mittal Steel of the Netherlands for \$4.8 billion. It is also worth mentioning the takeover of P & O by Dubai Ports World of the United Arab Emirates for \$8.2 billion.

## **UNITED KINGDOM**

The onward march of acquisitions in the UK by foreign companies increased from £15.5 billion in the last quarter of 2005, to £19.4 billion in the first quarter of 2006 **(13)**. The UK received two of the biggest cross-border M&As in the 2005/6 period. The largest was the takeover of telephone operator O2 by Telefonica of Spain for \$31.7 billion. The other was the takeover of Allied Domecq by Pernod Ricard of France for \$17.8 billion **(14)**.

However, what should also be acknowledged is that the UK is also a significant player in the takeovers of foreign companies, as Table 5 opposite shows there have been some sizeable takeovers by UK companies in 2005/6 and this is not likely to diminish. The contraction in the global market not only affects workers in the UK. Commentators should also consider what is happening to workers in other countries when UK investors takeover their companies. We can see the very diverse range of industries that investors are going for, from finance and insurance to defence and energy. There are significant gains to be made in these industries for investors, but these gains are nearly always at the expense of workers jobs, stable local communities and regional economic expansion.

There is also evidence that the significant home grown M&As are also having a big impact on UK employment rates, workers rights and local economies. For example, Barclays recently announced that 1,200 jobs **(15)** would be lost with the restructuring of their Woolwich business which it bought in 2000, closing 171 branches at the time. The majority of the jobs lost between 2006/8 will be at call centres in Clacton in Essex, and Dudley in the West Midlands, both areas of high unemployment, 200 branches across the UK will also close. While expenditure on M&As increased in the UK, from £5.3 billion in the last quarter of 2005 to £6 billion in the first quarter of 2006 **(16)**, consideration must be accorded to the impact of this trend in the UK economy as a whole.

**(12)** Office of National Statistics, First Release, 2 May 2006

**(13)** OECD – Trends and Recent Developments in FDI, June 2006, p 11

**(14)** Ibid, p14

**(15)** The Guardian, 29 June 2006.

**(16)** Office of National Statistics, First Release, 2 May 2006.

TABLE 4

<b>Mergers and Acquisitions of UK Companies by Foreign Investors</b>			
<b>UK Company</b>	<b>Industry</b>	<b>Takeover Group &amp; Country</b>	<b>Price</b>
O2	Telecommunications	Telefonica – Spain	\$31.7 billion
Allied Domecq	Drink	Pernod-Ricard, France	\$17.8 billion
Westinghouse	Energy	Toshiba – Japan	\$5.4 billion
National Grid-Transco	Gas Distribution in N. England	A Group of Hong Kong Investors (China)	\$2.5 billion
National Grid-Transco	Gas Distribution in Wales & S. West	Hydro-Tasmania Australia	\$2.2 billion
Paladin Resource	Mining	Talisman Energy – Canada	\$2.4 billion
Marconi Corp.	Telecommunications Equipment	Ericsson – Sweden	\$2.1 billion
MG Rover	Car Maker	Nanjing Automobile – China	unknown

*OECD-Trends and Recent Developments in FDI 2006*

TABLE 5

<b>Mergers and Acquisitions of Foreign Companies by UK Investors</b>			
<b>Foreign Company</b>	<b>Industry</b>	<b>UK Investor</b>	<b>Price</b>
Ruhgas Industries – Germany	Energy	CVC Capital Partners	\$1.8 billion
Skandia Forsakrings AB – Sweden	Insurance	Old Mutual	\$7.0 billion
United Defence Industries-US	Defence	BAE Industries	\$4 billion
Clearwave – Netherlands	Telecommunication	Vodafone Group	\$4.5 billion
Innovene	Energy	INEOS	\$9 billion
Korea First Bank	Finance	Standard Chartered	\$3.2 billion
Bank of China	Finance	Group of UK Investors acquired 10% stake	\$3.1 billion
Amerus-US	Insurance	AVIVA	\$3 billion

*OECD-Trends and Recent Developments in FDI 2006.*



### **THE IMPACT ON THE UK WORKFORCE**

At this point it is important to examine the implications of the growth in merger and acquisitions by foreign investors for UK employees and trade unions. To an extent the implications for employees and the trade unions that represent them are determined by the nationality of the 'buying' organisation. These organisations can be generically grouped as:

1. American Multinationals
2. European Multinationals
3. Others (primarily Asian Pacific/Japanese)

Despite claims that globalisation has led to a convergence in patterns of organisation between countries substantial differences remain in the nature of "national business systems" in which firms are embedded. One area in which these differences are stark is that of corporate governance and control. In particular, the characteristics and role of financial institutions, such as stock markets and banks, differ markedly across countries, while hostile takeovers are much more common in some systems than in others; i.e. America and the United Kingdom. Differences by nationality in the way that firms are governed and financed lead to different pressures being exerted on management.

#### **• American Multinationals**

Independent research (17) has shown that there is a robust and economically significant wage effect for both skilled and unskilled workers acquired by US multinationals. For skilled workers, this takes effect a period after acquisition and stands at more than +8%. The impact on unskilled wages is discernible at the period of acquisition and reaches nearly +13% after two years post acquisition. In stark contrast, no evidence is found for any causal effect on wages, skilled or unskilled, following acquisition by EU based multinationals. Research also indicated positive

unskilled wage effects the first two years (4.4% and 6.8%) following acquisition by multinationals from the rest of the world.

On the negative side, American multinational companies have long been associated with hostility to unions in their foreign operations (18). There is much evidence to suggest that American multinationals abroad have a relatively low propensity to recognise unions, and attempt to minimise their influence where they cannot avoid them. Even in countries such as Germany, with strong statutory supports for collective employee representation, US firms are depicted as seeking to avoid the constraints imposed by the host environment (19).

#### **• European Multinationals**

In European countries, particularly Germany, France and Austria, workforce representation in the company, legal rights of consultation and co-management in specific areas are of prime importance.

Conversely, in the United Kingdom obligations to recognise unions or establish structures of employee representation are limited, with the result that European multinationals from more regulated economies have the option to set up subsidiaries without adhering to employment legislation pertaining to their 'home' country.

Thus, it is argued that such "permissive" institutional and industrial relations frameworks allow European multinationals to be more susceptible to other factors in the business environment which influence corporate behaviour, such as the industry sector, production technology, profit and the cost of closure (20).

(17) *Evaluating the foreign ownership wage premium – Girma & Görg, Journal of International Economics, 2006.*

(18) *Geary and Roche 2001; Gennard and Steuer 1971; Gunnigle 1995; ILO 1976: 3–9; Royle 2001 (British Journal of Industrial Relations 43:4 December 2005 0007–1080 pp. 703–728)*

(19) *DeVos 1981; Muller 1998; Royle 2004 (British Journal of Industrial Relations 43:4 December 2005 0007–1080 pp. 703–728)*

(20) *Ferner, A. (1994). 'Multinational companies and human resource management: an overview of research issues', Human Resource Management Journal, 4 (3), pp. 79-102*

#### • Others (primarily Asian Pacific/Japanese)

With Japanese multinationals, restructuring and the 'employment adjustments' which often accompany it have become an increasingly important issue in recent years, following a long period of economic growth during which employment stability was the norm. Traditionally, when Japanese multinationals (although this does not apply to all businesses) have an excessive number of staff, they do not rush into job cuts, but instead adopt measures such as reduced working hours, not renewing fixed term contracts and limiting recruitment (21). However, since the late 1990's the number of Japanese multinationals engaged in restructuring and workforce rationalisation has been increasing and even those companies which in the past strongly supported employment stability for their workforce have begun to show a change of direction. Evidence of this was the closure of the LG Phillips Displays factories in Newport and Durham in 2003 with the loss of over 1500 jobs, as well as the closure of Sony and Hitachi factories in Wales involving over 1400 jobs.

#### **REDUNDANCIES**

Some mergers are accompanied by new investment to upgrade existing assets and acquire new ones. In other cases the rationale for mergers is to redeploy and intensify the way existing assets are utilised. Other mergers may involve operations being slimmed down or disposed of altogether. Mergers and acquisitions are often associated with significant numbers of job losses. Senior management teams commonly justify merger proposals to shareholders on the basis that cost savings will be achieved through getting rid of duplicate functions. This tendency is particularly evident in domestic mergers in Britain and is also evident in international mergers involving British firms. The financial sector is one in which this is particularly marked, with a wave of mergers being accompanied by large-scale job losses. For example, the recent merger between British American Financial Services and Zurich Insurance was followed by 1,600 jobs being lost in their British operations. The oil sector has also been affected by some huge mergers, many of which have led to redundancies. The tie-up between BP and Amoco saw 6,000 jobs being cut worldwide, with some of these occurring in Britain.

#### **TERMS AND CONDITIONS**

Mergers and acquisitions are often associated with changes in pay levels and in the nature of the systems used to determine pay, as well as changes in job descriptions, responsibilities and in individuals' positions within the hierarchy. The ability of management to change the terms and conditions of its workforce following a merger or acquisition is constrained by legislation, but while this limits the ability of senior executives to make unilateral changes to pay levels, it leaves some scope for changes to other aspects of workers' jobs.

The wave of mergers and acquisitions is a phenomenon which is clearly being driven by senior executives and their advisers. Trade unions are at best involved in negotiating the consequences of mergers and acquisitions, but rarely in the initial decision about whether to merge and whom to merge with. This appears to be a common picture across Europe. However, there is some variation across European countries concerning the extent to which unions are able to shape the key decisions affecting the workforce. In some countries unions have little institutional or legal basis on which to influence such decisions and are dependent on their bargaining power and the approach of management. This is certainly true for the UK where unions have expressed considerable concern about the employment effects of mergers and acquisitions but have been able to exert relatively little influence over numbers of job losses and only in exceptional cases have they been able to alter the merger and acquisition plans significantly.

Elsewhere in Europe, in contrast, the impediments to takeover that exist enable management to pursue long-term goals such as growth in market share. The greater confidence that both management and employees have concerning the stability of ownership encourages the development of implicit contracts between management and employees. These make it more likely that management will seek to develop the skills of its workforce and also give employees more incentive to invest human capital in their firm. This leads us to the conclusion that the UK government's commitment to weaker employment protection is potentially costing the country thousands of vital and well paid jobs and undermining the manufacturing economy.

(21) Office of National Statistics, First Release, 2 May 2006.

### **PROTECTIONISM**

A number of significant national security events have ensured that issues around defence, terrorism and national security have resulted in a number of industrialised nations moving towards a protectionist approach regarding certain mergers and acquisitions. Recent examples of this are the takeover of P&O by Dubai Ports World of the United Arab Emirates, where internal concerns arose because of the P&O ownership of six port operation services in the US. The takeover was opposed by Congress until Dubai Ports World agreed to divest the merged company of the ports in the US. In the UK, the defence company BAE systems, originally publicly owned, has a proviso that there is a limit of 29% ownership for outside investors. While in Germany the Foreign Trade Act and Regulation was amended to stipulate that any proposed acquisition of more than 25% in a German company producing armaments, ammunition or cryptographic programmes must be reported to the Federal Ministry of Economics and Labour.

There are also serious concerns about the investment in natural resources by foreign investors. This is particularly true of hydrocarbons where in many countries a form of 'resource nationalism' exists, especially in Russia, the US and the countries of South America. The situation can become so bad that agreements are torn up, additional conditions are levied on foreign investors and in one case in Argentina, the company was nationalised to protect it from a foreign takeover bid.

For some countries certain companies hold high levels of social and cultural importance. Laws are created and sometimes companies are nationalised to protect them from outside investors. For example, in Germany specific legislation was passed in 1960 to protect the car company Volkswagen from foreign investors and hostile takeover bids. The 'Volkswagen Law', forbids individual shareholders from holding more than 20% of the car

maker's voting rights, and established that important decisions regarding the future of Volkswagen requires the approval of at least 80% of the shareholders. Unsurprisingly, the EU Commission has referred Germany to the European Court of Justice as they claim the Law impedes the free movement of capital.

In December 2004, the French Government introduced a law which reformed its foreign investment rules (22) the new law requires the French government to issue a Ministerial decree setting out the types of conditions that may be imposed on foreign investment. In 2005 a new decree set out the list of different sectors upon which the investment restrictions apply. There are 11 sectors including security of information systems, cryptology services and activities involving design or supply contracts with the French Defence Ministry (23).

### **ADVANTAGES AND DISADVANTAGES OF FOREIGN INWARD INVESTMENT**

The following list identifies the pros and cons of FDI across the globe:

#### **Advantages:**

- FDI contributes to economic growth, productivity and GDP;
- Foreign companies have the capacity to encourage a highly skilled, highly paid workforce to blossom, which could generate substantial benefits to the economy;
- Foreign owned firms usually pay higher wages, especially in developing countries. For example in research undertaken in five African countries, FDI improved wages at individual worker level (24);
- FDI encourages the workforce to become more skilled. This can aid their job prospects and potential earnings, for example research in the Irish labour market found that FDI was associated with skill upgrading and increased wage dispersion in Irish manufacturing (25);

(22) 'Reform Law' Article 30 of Law No. 2004 – 1343, 9th December 2004.

(23) Decree No. 2005 – 1739.

(24) DW te Velde and O Morrissey (2001) 'Foreign Ownership and Wages: Evidence from Five African Countries' (25) Figini and Gorg (1998) *Multinational companies and wage inequality in the host country: 'The Case of Ireland'*. Trinity Economic Paper no 98/16

- FDI can encourage a programme of investment in general education in the host country. Not only to meet the required skills needed by the foreign investor but also to promote education generally (26);
  - With the development of linkages, foreign investors can be fundamental to creating regional economic activity. This enables smaller local companies to recruit more staff, become more economically active and produce greater profits;
  - Unlike mergers and acquisitions, FDI as a 'greenfield' site should produce substantial employment opportunities;
  - FDI could encourage skill-specific technological change resulting in faster productivity in the labour force in general;
  - FDI can facilitate skill-specific pay bargaining. Skilled workers are usually in a much stronger bargaining position than unskilled workers;
  - FDI encourages the economies of the developing world to become more industrialised and embrace Fordism, i.e. where mass production combines with mass consumption to produce sustained economic growth and widespread material advancement.
- Disadvantages:**
- Inflows of FDI do not necessarily mean that workers in the host country become more affluent. There is evidence that although there is an inflow of FDI any profits made outflow back to the parent nation of the transnational corporation. There is also evidence that the poorest unskilled workers do not benefit at all from FDI (27);
  - FDI could have serious effects on the health and working conditions of workers in developing countries if there are no regulations or policies to control expansion and protect workers. In the first half of 2001, 47,000 workers were killed at work in China (28) and the IMF is currently calling for compensation for 1,000's of workers who have been exposed to cadmium poisoning at the Gold Peak Industries factories in Huizhou province. The workers are facing extreme poverty due to high health bills and their unemployability (29);
  - The system of FDI in any nation state should be regulated, but in developing countries it should be regulated stringently with the implementation of FDI Policy Instruments (PI's). Policy Instruments are needed to respond to business decisions by transnational corporations. They are devised to shape the economic environment of the host country in order to attract and retain high levels of value added FDI. If this is not done transnational corporations could exploit and control countries that often have a smaller GDP than the income of the transnational corporations;
  - There is no direct link between poverty reduction and FDI in developing countries. However there is evidence that FDI can encourage an enabling economic environment;
  - Foreign companies may pay higher wages than local companies. As a consequence of this, wage inequality could increase the skilled/unskilled wage differentials and have a detrimental affect on a local firm's ability to employ staff and remain solvent;
  - Mergers and acquisitions do not usually increase employment opportunities. There is substantial evidence that a reduction in the workforce, often through redundancy or early retirement, is what usually happens. This can have a disastrous effect on workers who may be near retirement age or who are working in an area of high unemployment;
  - The power and influence of transnational corporations can result in an undue influence on government policy of the host nation. Preferential tax incentives could be introduced and government grants could be offered which local companies would not have access to or the benefit of;

(26) DW te Velde (2001) 'Government Policies for Inward Foreign Direct Investment in Developing Countries: Implications for human capital formation and income inequality'

(27) Overseas Development Institute, Briefing Paper, Foreign Direct Investment: Who Gains? April 2002.

(28) Garrett Brown (2002) 'The Global Threats to Workers' Health and Safety on the Job' – Social Justice, Vol. 29, no 3.

(29) HAZARDS: Risks 263, 1st July 2006.

- The closure of factories and the loss of jobs when a foreign investor decides to go elsewhere can create a boom/bust economy. It can also have a drastic detrimental affect on regional economies and profoundly affect workers lives and communities. For example, MG Rover was the last British volume car manufacturer in the UK and its collapse in 2005 had a symbolic significance as great as its economic significance. The closure meant that 5500 jobs were lost at the company with a further 18,000 related jobs in parts and suppliers. Amicus carried out a survey of former workers to ascertain their employability and what employment (if any) they had achieved and established that the majority were employed in jobs outside of manufacturing and on lower earnings;
- International banks and investment agencies become heavily involved in financing FDI. This can lead to the creation of financial empires that control developing countries and have a detrimental effect on the balance of payments of industrialised nations. In 2004 Brazil paid foreign bankers \$46 billion in interest and principle, while only receiving \$16 billion in new loans, leading to a net outflow of \$30 billion (30);
- The capital markets across the world are dominated by three US investment banks. A number of very high profile class actions have thrown doubt on the term 'Trusted Advisor' and have instead highlighted an industry that has been accused at best, of running a cartel and at worse, of working to produce profit for its own consumption and not for the shareholders and investors it is supposed to defend (31). The industry can exert a control over the economies of nation states via transnational corporations that is for the most part unregulated and open to manipulation and self aggrandisement.

### **AMICUS RECOMMENDATIONS**

1. There should be no 'open-door' policy to FDI. There needs to be a national consensus between the Government, the local private sector, trade unions and other sections of civil society;
2. It is imperative that Policy Instruments are implemented to regulate transnational corporations and ensure that the host country and its workers are not exploited. Policy Instruments are devised to shape the economic environment of the host country in order to attract and retain high levels of value adding FDI;
3. Mechanisms need to be put in place to ensure that FDI is used to reduce poverty in developing countries and provide employment opportunities for the poor by promoting sustainable economic growth and development;
4. FDI should be used to increase skill-training for key workers, provide development and training for other workers and also to substantially increase the general level of educational development for the population in host countries.
5. FDI should be used to increase the wages of workers in host countries without adding to wage inequality;
6. While encouraging FDIs to invest in their economies, governments should also ensure that workers rights and jobs are protected and health and safety regulations are implemented by passing legislation to support this;
7. There is a need for an independent agency to regulate FDI in developing countries, and retain an objective view regarding FDI and its benefits for developing nations;
8. A multilateral framework agreement on FDI should be created to address the existing anomalies and deficiencies of the rules governing FDI internationally;
9. There should be strict guidelines and regulations to ensure that any grants awarded to transnational corporations are repaid if the original promises regarding scale of investment, creation of jobs, and adherence to timescales are not kept.

(30) James Petras, *Six Myths about the Benefits of Foreign Investment* – Global Policy Forum 2 July 2005.

(31) See Maxwell, Barings, Enron and Guinness examples in Philip Augar, *The Greed Merchants – How the Investment Banks Played the Free Market Game* p.11

# Public sector procurement



# Public sector procurement

The UK Government is fully committed to the concept of procurement for public services within the UK, and in the wider global economy of Europe and international nation states. Procurement is described as ‘the process of acquiring goods, works and services, covering both acquisition from third parties and from in-house providers (32). This procedure is designed to cover the life span of the process, from the identification of a need, through to the end of the awarded services contract, or end of the useful life of an asset or the completion of a building project.

In the context of the procurement process, the most significant parameter is that of obtaining ‘best value for money’. The way to achieve this and the regulation that provides for this indicates that it is the tendering bid that offers ‘the optimum combination of whole life costs and benefits to meet the customer’s requirements (33). This does not mean the lowest price option, it means an assessment is required regarding the ongoing revenue/resource costs as well as the initial capital investment. Three new considerations also need to be taken into account. These are the social, environmental and health and safety implications of the awarding of a tender contract.

In the UK, central Civil Government spends £125 billion (34) each year on procurement. In 2000 the Office of Government Commerce (OGC) was established to work with the various agencies involved in procurement to improve their capability and capacity. Procurement practice is significantly more developed and sophisticated in the UK than in other European countries. Procurement has a high profile in the UK and is supported extensively by all government departments, and in particular the Treasury. All public services depend on government departments, agencies and other bodies purchasing goods and services. When conducted efficiently, procurement can make a vital contribution to the delivery of public

services in the UK. This means departments can achieve their core objectives in providing services to the public. If the procurement process is not used in an effective way then departments could find they do not have the required goods and services in place when needed and the public could suffer from lack of services or poor or non-existent delivery.

The Office of Government Commerce had responsibility as part of the Treasury’s Public Service Agreement for delivering £1 billion of value for money savings in the three years up to the end of March 2003. For the subsequent three years, 2003 – 2006, the OGC has a new target of £3 billion of savings (35). The long term sustainability of improvements in value for money depends on improving the procurement capability of departments. Government action can either help or hinder this capability. The Kelly Report 2003 (36) indicated that there is a potentially wider economic aspect to procurement in the UK. Better capacity planning on the back of government contracts, and more effective competition for these contracts should not only provide value for money for the UK tax payer, but could show overseas procurers how effective UK companies are, and encourage them to offer contracts to UK companies (37). The report also included an action plan with specific targets, dates and department commitments. This action plan reinforces the UK Government’s long term commitment to public procurement.

Under European legislation, public sector contracts issued by government bodies, local authorities and utility companies to a value of over £100,000 must be advertised throughout Europe in the Official Journal of the European Union (OJEU). The aim is to ensure that public sector contracts are exposed to the largest group of prospective tenders, not only to those member states that

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(32) *National Procurement Strategy for Local Government, October 2003, p17.*

(33) *Ibid*

(34) *This figure includes the National Health Service and Defence military procurement*

(35) *National Audit Office – Improving Procurement, p.24*

(36) *OGC Report to the Chancellor of the Exchequer-Increasing Competition and Improving Long-term Capacity Planning in the Government Market Place, December 2003*

(37) *OGC Report to the Chancellor of the Exchequer-Increasing Competition and Improving Long-term Capacity Planning in the Government Market Place, December 2003, paragraph 26.*

make up the European Union, but also the EFTA countries Lichtenstein, Norway, Iceland and Switzerland, and any other companies regulated by international agreements that would like to tender. The UK Government has made it evident that they view the process of public procurement as essential to the proper functioning of the European Union within the global economy.

The public market across the European Union is worth in excess of €1,500 billion per annum, representing 16% of European Union gross domestic product (GDP) (38). For UK companies interested in pursuing new markets in Europe, the tendering process should offer them an opportunity to realise their potential expansion in a new market in Europe. This could enable them to sell their product, create the opportunity to fulfil contracts in other countries, or enable them to become a significant player in this new market place. However, less than 10% of public purchasing in the European Union is accounted for by direct cross-border trade; where one company based in a member state sells to a buyer in another state. This is half the amount found in the private sector (39). Indirect cross-border trade where a company sells via a subsidiary located within the same member state, with their headquarters being in another member state or outside of the European Union altogether, represents 30% of European public procurement (40).

Whilst the UK Government is committed to a strict monetarist economic policy where the free market prevails and competition is the credo, it is also right to acknowledge the investment made in skills and research and development. However, market liberalisation in the UK is far in advance of other European Union countries. As a consequence of this, the UK market has been opened up extensively to the companies of the European Union and many other international companies who want to tender for the contracts are also benefiting. For example, Damovo, the American global services company has been

awarded a three year contract with the British NHS purchasing and supply agency worth £18 million. For many UK companies the UK Government's active solicitation of foreign investment is difficult to comprehend, especially when balanced with an apparent lack of support for UK companies trying to break into the European market. There is evidence that this policy is creating significant difficulties for companies based in the UK.

In many respects the procurement process can have an advantageous effect. In the pursuit of 'best value', the opportunity should arise for the most diverse and innovative companies to tender for contracts, and the opportunity for extensive competition should ensure that the 'best' companies come to the fore and are awarded the contracts. However, Amicus believes this is not happening and is an oversimplified and naïve view of what is actually occurring in the European and global market. Coupled with this is a UK Government that has made a firm commitment to the free market, competitive tendering and international competition (41).

### **MARKET LIBERALISATION AND THE EUROPEAN UNION**

While the UK has moved in the direction of a fully liberated market, the extent of market liberalisation in other European states is significantly lower. This partially liberated position in the European Union has resulted in a lack of both transparency and competition in the EU market. However, in any discussion on market liberalisation, consideration needs to be given to the very different stages in which the 25 member states are starting from. For member states such as France or Germany however, their longevity within the European Union should indicate a situation where their markets are as liberated as the UK, in accordance with EU legislation and regulations. Evidence shows that this is not the case (42), and it is clear there are significant cultural, regional and political resistances to market liberalisation within their economies.

(38) *Internal Market Strategy, Priorities 2003 – 2006, May 2003.*

(39) *Ibid*

(40) *The Functioning of Public Procurement Markets in the EU: European Commission, February 2004.*

(41) *2004 Budget, Gordon Brown, Chancellor of the Exchequer, 'competition promotes efficiency, controls inflation and creates choice for consumers'.*

(42) *e.g. trains used by Spanish railways must have proportion built in Spain*

UK market liberalisation is seen as one of the key issues affecting UK companies. This is particularly acute when foreign firms competing in the UK market are state-owned or state subsidised and therefore not exposed to the same competitive pressures as UK companies. The degree to which public procurement markets in Europe are open to UK companies is significantly affected by a number of key factors. These include cultural differences, political influence, industrial policy, slow or non-existent market liberalisation and the decentralised nature of many of the largest European Union member states. France and Germany both present problems regarding all of these factors, yet are two of the biggest markets in the European Union. There also seems to be indicators that Spain systematically flouts the EU regulations regarding procurement (43).

Cultural differences are particularly prevalent where procurement is concerned, where buying locally is the norm and no amount of legislation or regulation from Brussels will change this. For many UK companies recognising this cultural barrier has forced them to find alternative ways of working. There is evidence that a large number have either acquired a smaller company in the locality to enable them to work within the region, or have employed agents in the region or industry to smooth their path or enable them to overcome specific cultural, social or language barriers. For example, a European Union report found that local firms win on average 35% of tenders in their home market even if they are under foreign ownership, while 30% are won via nationally owned companies and only 25% are won by companies bidding from a different country with no local connection (44).

Political influences can also have a critical effect on the awarding of contracts. This is particularly so in regions far removed from central government, where local politicians rely on the votes of people who want to keep their jobs and companies that supporting them financially in political

campaigns. There can also be issues of high level lobbying by home market companies for contracts, especially where defence contracts are concerned, or where there are significant implications regarding jobs and regional prosperity.

Decentralisation causes momentous problems where public procurement is concerned. In France there are 40,000 different public procurers issuing tenders in the Official Journal of the European Union (45). France also has a culture where strategic industries are identified and supported by government. French industrial policy ensures that long-term investment plans are published and there is extensive, pro-active dialogue with national suppliers and the French ministries. French industrial policy includes intense lobbying of the European Commission for more flexibility in the application of competition, financial and environmental regulations to encourage the growth of strong French industries. The policy also includes plans to stimulate French industry through research and development, including the creation of committees for strategic reflection, looking currently at the long term future of the textile, health and automotive sectors (46).

In Germany there are 35,000 public institutions with a procurement function (47). German public procurement operates within a very complex framework of legal and administrative systems and the co-ordination of local and regional public procurement presents considerable problems for central German authorities due to the federalist state structure. All of these add to the barriers experienced by UK companies. There are also complex regulations in Germany regarding national standards, in particular the DIN standards (48) and TÜV certification requirements. To confuse UK companies even more TÜV requirements can differ from one region to another (49). German authorities are entitled to require these standards if there is no equivalent under European Union or international law.

(43) *The Wood Review, November 2004, p.27*

(44) *The Functioning of Public Procurement Markets in the EU, European Commission, February 2004.*

(45) *Improving Procurement: Case Studies and International Comparisons, p.29.*

(46) *Questions-Responses Politiques, Le Monde Economie, 10 February 2004.*

(47) *Improving Procurement: Case Studies and International Comparisons, p.24.*

(48) *Deutsches Institut für Normung e.V. www.en.din.de/*

(49) *Ibid*

### **PUBLIC PROCUREMENT AND SMALL AND MEDIUM SIZED ENTERPRISES (SME'S)**

The European Commission and the UK Government both acknowledge that the failure to access public procurement contracts is particularly acute for small and medium sized enterprises (SME's). This clearly indicates that there is inherent discrimination in the process of procurement in the European Union. There are 3.5 million businesses in England and all but 5,400 are either small (with fewer than 50 employees) or medium (with 50 to 249 employees) workplaces (50). SME's are found in all sectors of the economy, account for half of all business turnover and employ 57% of England's private sector workforce.

The very possibility that UK SME's could tender for these lucrative European contracts is clearly unrealistic. The process of procurement in the UK market is complicated enough, but in the European Union it is even more complex, costly and time consuming. The UK Government has been working to try to address these problems and support SME's in overcoming the current barriers to their entry into the European Union procurement market. The UK Government has implemented a number of key initiatives to assist SME's, including the establishment of the Small Business Service (SBS), a simplified National Pre-Qualification Questionnaire, recommendations for the standardisation of accreditation models and the production of the Small Business Concordat (51). However, it is clear from evidence that the barriers are not being broken down and further work needs to be done by the agencies concerned. For example, of the 367 local authorities in the UK only 66 have so far signed up to the Concordat (52).

It is clear that too many administrative and bureaucratic regulations have a detrimental effect on SME's working in Europe. In an already lightly regulated market the UK Government has taken further steps to reduce the burden

of bureaucratic regulations on SME's. This includes a programme of administrative burden reductions and a consolidation of regulatory and inspection bodies. However, a study by the Federation of Small Business found that SME's are still dissatisfied with the volume and complexity of administrative regulations and the high rate of change in employment and company legislation (53). In the light of this, and the previous discussion regarding the decentralized nature of many of the European Union member states, it is difficult to see how SME's are going to access the information they need to enable them to trade in Europe, and steer a course through the regulatory minefield that is the European Union public procurement market.

**TABLE 6**

<b>Advantages</b>	<b>Number of Employees</b>				
	<b>0</b>	<b>1-9</b>	<b>10-49</b>	<b>50-249</b>	<b>Total</b>
Larger selling market	14%	19%	25%	28%	17%
Simplified International collaboration	12%	17%	19%	25%	14%
The euro	10%	17%	15%	25%	13%
Lower transaction costs	8%	13%	14%	19%	10%
Larger labour market	5%	6%	6%	9%	5%
Lower transportation costs	4%	6%	7%	10%	5%
Lower production costs	4%	5%	4%	5%	4%
No advantages	64%	48%	43%	33%	56%

<b>Disadvantages</b>	<b>Number of Employees</b>				
	<b>0</b>	<b>1-9</b>	<b>10-49</b>	<b>50-249</b>	<b>Total</b>
Greater competition	22%	32%	35%	40%	27%
Costs of the euro	7%	8%	8%	8%	7%
Higher production costs	6%	6%	5%	5%	6%
Increased regulation	16%	16%	21%	27%	17%
No disadvantages	57%	47%	42%	37%	52%

**European Commission, The European Observatory for SME's, 2000, EIM and ENSR, Luxembourg, 2000.**

(50) *Mapping of Government Services for Small Businesses, PACEC, 2005.*

(51) [www.odpm.gov.uk/index.asp?id=1136698](http://www.odpm.gov.uk/index.asp?id=1136698)

(52) *Lifting the Barriers to Growth in UK Small Business - Biennial Survey 2004, Federation of Small Business.*

(53) *Ibid*

Table 6 shows that for smaller businesses there are concerns expressed about the disadvantages of greater competition and increased administrative regulation with doing business in the European Union. 48% of companies surveyed who have 9 or less employees think there will be no advantages to them pursuing the extended market in Europe. The table also shows that the larger the company the more positive the response and according to SME's in manufacturing and construction, the major plus factors for the European Union market are the larger selling market, simplified international collaboration and lower transaction costs. Other studies on the impact of the extended European Union market showed that large companies are in a better position to take advantage of economies of scale and increase profits accordingly (54). While for SME's the adjustment is slower, their resources are smaller and their capacity to pursue new markets is reduced, this means that opportunities open to larger companies are closed to them, consequently they are unable to participate fully in the European Union market place.

#### **UK GOVERNMENT IMPACT**

The UK Government has invested a great deal of money and resources into promoting public procurement. This includes the setting up of a number of key agencies, including UK Trade and Industry (UKTI), the organisation set up to support UK companies trading internationally and for overseas enterprises looking to locate in the UK, the Office of Government Commerce (OGC), an agency of the Treasury, set up to act as a catalyst for achieving best value for money in procurement and the DTI section called Business Links, which provides advice to UK businesses through a network of regional offices, linked to the Regional Development Agencies. There are also European initiatives such as the Euro-Info centres. These are a network of three hundred support agencies located throughout Europe, partially funded by the European Commission to provide companies with advice on any European market issues including access to public procurement contracts.

Regardless of the current investment in promoting public procurement to UK companies, UK industrial policy does not benefit UK businesses abroad as much as it should. This is especially true where public procurement is concerned. There is almost no sustained industrial strategy regarding UK manufacturing. Ultimately this will have a negative effect if, as public investment increases and contracts are secured, the industrial capacity and skills base of UK manufacturing may no longer exist and contracts will be awarded elsewhere. Continental suppliers have a competitive advantage whereby they can service, support and manufacture goods in their own country. For many once flourishing UK industries this is no longer the case. While in France and Germany high level government policy and investment was secured to support these industries over the long term, in recognition of the importance of their manufacturing base and capacity to secure public procurement contracts. UK manufacturing cannot compete on these terms, and this level of European support is seen by UK companies as securing a significant international competitive advantage for their European counterparts. A comment from the CEO of a manufacturing company in the UK indicated "in Britain, public authorities are concerned about value for money for the British tax payer and not about looking after the national industrial base (55)."

The failure of the government to address domestic procurement opportunities is vividly displayed in its approach to the railway industry and train building. In a recent report (56) Europe Economics present a clear case for a more strategic approach from government (Department for Transport) in the whole procurement process. The report is critical of the government for failing to have a single body which takes a strategic overview of the new vehicle purchasing profile. The net effect of which is huge fluctuations in orders for new trains, resulting in massive changes in the workload for rolling stock manufacturers. As a result, the report finds,

(54) O Döhrna and Roland, *Impact of the Enlargement of the European Union on Small and Medium Sized Enterprises, Rheinisch – Westfälisches Institut für Wirtschaftsforschung, Essen and Glasgow, 2000.*

(55) *The Wood Review of European Public Procurement, November 2004, p.34*

(56) *Bombardier Transportation: the future of the Derby plant: A report by Europe Economics Nov 2005*

manufacturers have been asked to produce some 4500 cars over the last 10 years and this has now dropped close to zero for the next 3 years. The only way for manufacturers to handle the “feast” and “famine” order placement is to plan their workload across national boundaries and rationalize the number of manufacturing sites on a global basis, thus placing UK jobs at risk.

### **EXAMPLES OF BREACHES OF PROCUREMENT REGULATIONS**

The following examples are taken from the Wood Review of one hundred companies who responded to the original consultation. The methodology included written responses, questionnaires and individual interviews. The majority of the companies are from the services, construction and manufacturing sectors.

**A UK industrial company competing for a regional contract in Spain offered the lowest cost and best technical specification, and yet lost out to a company whose local partner was contributing to the appropriate political party and had already won many bids with the local authority.**

*The Wood Review, p.23.*

**A UK company was invited to submit a bid for an electronics contract in France. The only other bidder was a French company. The UK company was told they had lost the bid on technical grounds. They believed their bid to be technically compliant, as well as being 10% lower on cost than that of their competitor and with better delivery terms. The UK company felt that the invitation to bid had been made solely to satisfy the need to generate competition. When no information was forthcoming from the procuring authority as to how the decision had been made (as required under EU rules) and no satisfactory response was received to lobbying by the UK ambassador with the appropriate French minister the UK company decided to take further action.**

*The Wood Review, p.24.*

**A leading UK supplier submitted a bid as a sub-contractor for a public transport contract in Spain through a locally based private sector main contractor. The procurement appeared to be proceeding successfully. Spanish speaking representatives were involved and the UK company was told their prices were good and competitive, and that a decision would be forthcoming on a given date. The date came and went and the suppliers’ follow up calls went unanswered. The company was finally told by a manager from a different country office of the main contractor, that they had lost the contract due to a ‘political decision’ to work with a Spanish sub- contractor.**

*The Wood Review, p.27.*

There are a number of other examples of breaches of the EU regulations. These include the extemporised and unreasonable requirement for tender bids to be submitted in a regional language as this would significantly disadvantage any bidder not from the region. The reason given was that this was the language spoken by the procurement panel. Another example is the interpretation of phrases within the regulations. For example, other European Union countries opt for a wider interpretation of what 'warlike' represents regarding goods and services, whereas in the UK the range of goods and services covered by this term is very narrow. The UK is the only country in the European Union that does not classify military clothing as 'warlike' and therefore the only country to open up such procurements to competition under European Union rules. This is a good example of where UK manufacturers face competition in their home market without the corresponding opportunities in other European Union markets. Another example cited in the review mentioned that many European countries 'split' bids to reduce their need to be competitive (57). In Germany the 'splitting' of bids is enshrined in law and procuring authorities must justify themselves if they do not split bids. This actively disadvantages other tenders and although an argument could be made that this process encourages SME's to enter the market, we have already indicated that the regulatory process, cost and time element for SME's to tender makes it very unlikely that they would.

## AMICUS RECOMMENDATIONS

- The commitment of the UK Government is the key to nearly all the issues with public procurement in Europe. The UK Government needs to show its support for UK industry in an open and sustainable way. This Government involvement would empower UK industry and show the rest of Europe that UK businesses are strong, capable and effective;
- There needs to be a greater dialogue and understanding between government procurement agencies and UK business. There is evidence that there is very little interaction. This would be unheard of in France or Germany;
- There needs to be a greater understanding by procurement agencies of the manufacturing supply chain, the role of SMEs in that chain and the fragility of local capacity;
- The UK Government needs to talk to UK industry and the relevant trade unions to discuss a pragmatic, sustainable, long-term strategy for key industries within the sector;
- The UK Government needs to be more vocal, influential and pro-active in the making of policy and legislation within the European Union. It is the UK Government and their agencies that need to be promoting UK companies, supporting companies that have been the victims of breaches in the tendering rules and lobbying on behalf of British industry;
- There needs to be a more systematic approach from the DTI and greater accountability. At present there is little joined-up thinking or strategic working regarding the various Government agencies;
- UK Trade and Investment (UKTI) is not working as effectively as it could. Amicus recommends a 'one-stop-shop' for UK business, not only for information about procurement but also pragmatic advice about breaking into difficult markets and ways of circumventing insidious bid manipulation;
- Although there is a complaints and appeal process for companies that lose bids (as they see it) unfairly, many are loathe to go down this road. They quite rightly say that they cannot complain about a decision made in a market they are trying to break into. They are left to find out about the processes that other companies use to be awarded contracts. Procurement agencies in the UK need to take this on board and give pragmatic advice and support;
- The UK Government is clear about its focus on inward investment, and the UK now enjoys the highest level of inward investment in the world. However, this is not the whole picture. While welcoming inward investment, the same amount of attention, thought and resources needs to be put into assisting UK industry to procure abroad;
- Amicus believes that a mentoring system for inexperienced companies who are looking to enter the procurement market would alleviate many of the pitfalls and problems experienced by UK companies all of which are expensive in terms of resources, time and investment. The mentors would be UK companies experienced in the procurement process. This would be particularly effective for SME's wanting to trade with Europe;
- UK Government needs to understand the effect their ongoing fiscal policy is having on UK business. Market liberalisation is not uniform across the European Union and as a consequence of this UK companies are disadvantaged while overseas companies are advantaged. If the UK Government is as committed to competition as it says then this rigid commitment to liberalisation needs to be addressed.

# Global manufacturing development

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# Global manufacturing development

The performance of the manufacturing sector in the UK is inextricably linked to the global markets and the multi-national corporations which dominate them. In this chapter we examine the development of the new economies which are emerging across the world and the impact that these and the new European Union accession states will have on the future of UK manufacturing.

Firstly we examine the potential impact of the four largest world growth economies, Brazil, Russia, India and China known collectively as BRIC.

## **OVERVIEW OF BRICS THEORY**

According to a study by Goldman Sachs in 2003 (58) in less than 40 years the BRICs economies together could be larger than the G6 in US dollar terms. By 2025 they could account for over half the size of the G6 whereas currently they are worth less than 15% of G6.

As early as 2009 the annual increase in US dollar spending from the BRICs could be greater than that from the G6 and more than twice as much in dollar terms as it is now. By 2025 the annual increase in US dollar spending from the BRICs could be twice that of the G6 and four times higher by 2050.

Individuals in the BRICs are still likely to be poorer on average than individuals in the G6 economies, with the exception of Russia. China's per capita income could be roughly what the developed economies are now. By 2050 the largest economies in the world, by GDP, may no longer be the richest (by income per capita).

## **EFFECTS OF BRICS ON UK COMPETITIVENESS**

The UK slipped from 4th place in terms of GDP (at Market Exchange Rates - MER) in 2004, to 5th in 2005 and PWC (59) estimates that the UK will fall further to 9th place in 2050 (at MER) behind China, India, Brazil, Indonesia, Mexico and in terms of GDP, (measured with regard to Purchasing Power Parity - PPP), the UK will be around a tenth of the size of China.

In OECD countries GDP shares will decline but GDP per capita will remain higher than in emerging markets. PWC concludes that the favourable opportunities for emerging markets is not totally a zero sum game – UK only currently exports 5% to the 7 largest emerging markets and there are opportunities for growth in this area as spending power increases.

However, the transition process will be painful for some in Europe and especially in the UK. The short term outlook for UK manufacturing sector remains fragile and strong foreign competition and rising energy and raw materials costs will erode profitability. UK manufacturing output growth is expected to continue to lag behind that of other countries, contracting by 0.7% in 2006, significantly below GDP growth.

Europe will remain sensitive to changes in the global economy such as higher oil prices and currency fluctuations.

## **LONG TERM FACTORS AFFECTING PROSPECTS FOR THE UK**

### **GDP Growth**

Average annual UK GDP growth over the period from 2006 – 2015 is expected to be only around 2.3% according to the latest Consensus Economics Survey. This is below Treasury estimates of 2.75%.

### **Manufacturing**

A relative decline in manufacturing as a share of GDP is forecast due to increasing competition from lower cost producers in Asia and elsewhere. Emerging economies will continue to provide a flow of cheap imports to developed OECD countries. Whilst this has contributed to the boost in consumer welfare the negative impact on UK manufacturing was highlighted in the earlier chapter on the manufacturing economy.

On the plus side, as countries like China and India grow and open up their domestic markets this has created many new opportunities for Western companies to expand into these new markets.

### **Comparative and Competitive Advantages**

India poses an increasing competitive challenge in the IT sector as well as being a prime location for offshoring of back office functions particularly from English speaking countries such as the UK and US.

Manufacturing investment in China, India and other emerging economies is also posing a major competitive advantage, particularly in labour intensive industries, and with the rapidly increasing number of graduates and other skilled workers these countries will in future decades become effective global competitors in a range of other markets such as Japan.

It does seem likely that many individual workers will face actual or potential competition either from workers in the emerging markets and other low cost economies due to outsourcing and offshoring or from migrant labour moving to the OECD countries. This may constrain wage growth in the OECD countries while also tending to widen income inequalities within these countries. There

may also be a tendency for income inequalities to increase in OECD countries with low and medium skilled workers facing an increasing squeeze from lower cost workers in the emerging economies.

Within the UK the future strength of manufacturing is dependent upon, inter alia, its ability to innovate and convert ideas to marketable products. In terms of creativity the UK has a lower number of patents than Russia and China is now close behind as the table 7 below shows:

**TABLE 7**

Patents	
1. Japan	123,978
2. US	83,090
3. South Korea	34,052
4. Taiwan	20,094
5. Germany	18,328
6. Russia	16,340
7. France	11,290
8. UK	4,491
10. China	3,742

*Source: Asia Pacific Institute of Business, Chinese University of Hong Kong*

### **Demographics**

Demographic studies, (including UN projections), suggest that some countries are expected to have positive working age population growth in the period to 2050 due either to relatively high birth rates e.g. India and Turkey and/or high immigration rates e.g. the US. However, all of the OECD countries in Europe are facing declining working age populations, except the UK, which is expected to remain static. The same is also true of Russia and China.

**TABLE 8**

% of Population in Labour Force			
1. China	57.8	17. UK	50.5
2. Switzerland	56.7	21. New Zealand	49.9
3. Thailand	54.7	25. US	49.0
4. Iceland	54.2	27. Germany	48.5
5. Canada	53.8	32. Brazil	47.9
5. Denmark	53.8	33. Russia	47.7
7. Japan	53.1	36. Bangladesh	47.3
8. Norway	52.8	38. South Korea	47.3
9. Portugal. Singa	51.9	.....	...
10. Hong Kong	51.8	> 40. India	<46.8

*Source: Asia Pacific Institute of Business, Chinese University of Hong Kong*

The UK currently compares favourably in terms of percentage of population in the Labour Force.

Population and geographical size of China and India could mean that their impact is greater and longer lasting.

### **MOVING UP THE VALUE ADDED CURVE**

UK manufacturers have been urged to develop strategies to 'move up the value curve', i.e. to aim for niche markets and develop comparative advantages in research and development and high value goods production.

China and many other BRICs economies represent a challenge to this wisdom. From 2001 data, China, despite having fewer absolute and per capita numbers of graduates than Russia, deploys nearly as many workers in Research and Development as the US.

Although the US has more R&D workers, China has more than Japan and almost three times as many as Germany (see below). This should help China move up the value added curve.

### **CHALLENGES TO THE RISE OF BRICs:**

Each of the BRICs has been through periods of macroeconomic instability in the last few decades and some face significant macroeconomic challenges still, e.g. Brazil has suffered greatly from the precariousness of the public finances and the foreign borrowing this has brought about. The lack of stability in terms of political institutions is a further factor exemplified by the impact on recent growth performance in Russia.

Openness to trade and foreign investment and levels of education and the impact on productivity is an issue for countries like India which is still relatively closed and has a history of using protectionist measures such as high tariffs and has much still to do in expanding education.

In some cases e.g. India, Indonesia and Brazil, it is assumed that there will be a slower rate of technological progress in the short term but assumes the pace of catch-up accelerates in the long term as these countries strengthen their institutional frameworks.

China's growth to date has been driven by very high savings and capital investment rates but experience with Japan and other earlier Asian tigers suggests that such investment driven growth eventually runs into diminishing returns once income levels approach OECD levels. As China's population ages it is also likely that its savings rate will drop as assets are cashed in to pay for the pensions of its ageing population – although it is estimated that investment and savings will stay above OECD levels in the long run. China's unemployment rate is at 10% in urban areas (the richest) and moderate estimates of rural unemployment are 20%.

Indian transport, communications and energy infrastructure is in need of development and investment. Many manufacturers currently must provide their own generators. Infrastructure levels in India are currently well below BRICs averages.

There are also concerns that growth in Russia is not sustainable. Russia's current surge is based on high oil prices, which means that its economy is at the mercy of cyclical global energy markets. Russia has so far not diversified its economy.

Eventually, as income levels, labour costs and real exchange rates rise in the emerging markets as indicated by predictions, some gains may be eroded but not within the next ten years.

Some analysts believe BRICs are nothing more than a marketing ploy. Emerging markets had become unattractive investments since the crises of 1997 (Asia) and 1998 (Russia). "BRIC is to an extent a rebranding" the head of emerging markets strategy at UBS is quoted as saying.

To add to our understanding of the challenges facing manufacturing in the developed nations there follows comparative profiles of the BRIC economies.

# Brazil

## Prospects for growth

It is forecast that over the next 50 years, Brazil's GDP growth rate will average 3.6%. The size of Brazil's economy would overtake Italy by 2025, France by 2031, UK and Germany by 2036 (60).

However, Brazil has not been growing in line with projections and may have the most immediate obstacles to this kind of growth. Growth has been declining sharply since the debt crisis of the 1980s. External shocks combined with poor policy response amidst a political transition from a military to democratic regime.

In 2004, Brazil enjoyed more robust growth that yielded increases in employment and real wages. A floating exchange rate, an inflation targeting regime, and tight fiscal policy were all reinforced by a series of IMF programs.

## Characteristics of the Brazilian Economy

Brazil is characterised by large and well developed agricultural, mining, manufacturing and service sectors. From 2001-3 real wages fell and Brazil's economy grew, on average, only 2.3% per year.

In 2003 to 2005, Brazil ran record trade surpluses and recorded its first current account surpluses since 1992. Productivity gains – particularly in agriculture also contributed to the surge in exports.

## Competitiveness

Brazil is much less open to trade than China (where the tradeable goods sector is 8 times larger). Investment and savings are lower than in China whereas public and foreign debt is higher than in China.

The 2002 trade surplus was due more to the decrease in imports (-15%) than exports (3.7%) (61). Only the basic and semi manufactured good sectors, clearly benefiting from the devaluation, showed a significant increase in exports. There was a decrease of all other manufactured goods, especially those with a higher value added.

Due to the competitive pressure exerted by trade liberalisation, by increasing capital flows (including FDI), by exchange rate evaluation and by increasing interest rates, manufacturing companies have adopted defensive strategies in Brazil.

Despite the optimism surrounding the current trade balance, Brazil is still far from being competitive on foreign markets.

(60) Goldman Sachs Global Economics Paper 99: *Dreaming with BRICs: The path to 2050*

(61) Sarti and Sabbtini: *Trade, Foreign Investment and the Competitiveness Policy: Some Reflections on the Brazilian Situation*

# Russia

## **Prospects for Growth**

Russia's growth projections are hampered by a shrinking population but strong convergence rates work to its advantage. By 2050 its GDP per capita is forecast to be by far the highest in the group and comparable to G6 (62).

The effect of an ageing population will be to restrict Russia's ability to increase its share of world GDP in a similar way to large emerging economies. In the longer term the same factor will act as a drag on Chinese growth relative to that of India.

Russia ended 2005 with its seventh straight year of growth, averaging 6.4% annually since the financial crisis of 1998. High oil prices and a relatively cheap rouble have been contributing to this economic rebound. Russian people have seen real personal incomes realise average increases of over 12%, whilst poverty has declined steadily and the middle class has continued to expand.

## **Manufacturing**

The manufacturing base is dilapidated and must be replaced or modernised if the country is to achieve broad based economic growth. State control has increased in the past year with a number of large acquisitions.

## **Competitiveness**

The country had enormous advantages over other developing states. A well educated workforce, most of the former Soviet Union's assets and enormous wealth in natural resources. It had also survived the 1998 financial crisis.

The recent economic performance has seen foreign debt decline from 90% of GDP to 31%. Economic growth slowed to 5.9% for 2005 while inflation remains high. The country benefits from strong oil export earnings with oil, natural gas, timber and metals accounting for more than 80% of exports. However, this leaves the country vulnerable to swings in world prices.

Russia is the world's no.1 exporter of gas and the no.2 exporter of oil. Energy related revenues account for more than 20% of GDP, which mean that high oil prices have allowed the Kremlin to ignore the need to diversify the economy by enabling entrepreneurship and investment in non energy related research and development. Brazil, India, and China have neither Russia's oil and gas resources nor the temptations they offer to resist foreign investment and economic diversification.

Corruption and widespread lack of trust in institutions contributes to a poor business environment that discourages both domestic and foreign investors.

# India



## Prospects for Growth

It is estimated that only India will see growth rates significantly above 3% by 2050. India's economy could be larger than Japan's by 2032. It has the potential to show the fastest growth over the next 30 and 50 years and could be higher than 5% over the next 30 years and close to 5% in 2050 if development proceeds.

With the only population of the BRICs that continues to grow throughout the 50 years, India has the potential to raise its US dollar income per capita in 2050 to 35 times current levels – but this will still be at a lower level than other countries.

Average living standards in India in 2050 will roughly be on a par with Spain today yet despite strong growth, the World Bank and others worry about the combined state and federal budget deficit, running at approx 9% of GDP.

## Characteristics of the Indian Economy

India has one of the largest domestic markets in the world and a large labour force available at relatively low cost. It has an abundance of well educated workers, particularly in areas of engineering and science.

Traditional sectors such as engineering goods and textiles are witnessing extraordinary growth. Textile exports for 2005-6 stood at \$17 billion, a rise of over 26% whilst exports of engineering goods grew at over 28%. There was over 40% growth in items like transport equipment, iron ore and pharmaceuticals. Many core sectors that were once monopolies of the government have been privatised e.g. telecoms, energy production/distribution, oil and natural gas, iron and steel, aviation, financial services etc.

## Manufacturing

India achieved 7.6% GDP growth in 2005, significantly expanding its manufacturing sector. Its automotive sector grew at a healthy 13% in 2005-6 with total production nearing 10 million units including passenger cars, motorcycles, tractors and commercial vehicles.

India benefits from a large and skilled, yet comparatively low cost, human resource for the entire spectrum of activities – from knowledge intensive R&D design, and software services, to labour intensive manufacturing activities.

## Competitiveness

To attract FDI, the Government of India is aggressively pursuing special economic zones similar to Chinese SEZs. These provide a business friendly regulatory environment, modern infrastructure and fiscal incentives like tax exemptions, total repatriation of profits and 100% ownership for setting up manufacturing facilities. India has also amended its laws for protection and enforcement of intellectual property rights; however regulation does vary across Indian states.

High tariffs (averaging 20% on non agricultural items in 2004) and limits on FDI are still in place. However, the government in 2005 liberalised investment in the civil aviation, telecom and construction sectors.

However, India does suffer from huge transport cost disadvantages due to delays and inefficiencies in Indian ports compared to their Asian counterparts.

# China

## Prospects for Growth

China's GDP growth rate is forecast to fall to 5% in 2020 from its 8.1% growth rate projected for 2003. By the mid 2040s growth slows to around 3.5% (63). Even so, high investment rates, a large labour force and steady convergence would mean China becomes the world's largest economy by 2041. China is projected to remain the fastest growing BRIC economy for the next few years but is gradually overtaken in terms of growth rates by India in 2013 and Brazil in 2023.

## Changes in the Chinese Economy

China's economy during the last 25 years has changed from a centrally planned system that was largely closed to international trade to a more market orientated economy that has a rapidly growing private sector and is a major player in the global economy. Reforms started in the late 1970s with the phasing out of collectivised agriculture and expanded to include the gradual liberalisation of prices, fiscal decentralisation, increased autonomy for state enterprises and the foundation of a diversified banking system. Economic development has generally been more rapid in coastal provinces than in the interior and there are large disparities in per capita income between regions.

## Competitiveness

China's enormous market and manufacturing excellence, along with India's growing consumer market, significant natural resources, and software excellence can generate sustainable regional development. Complementary relationships have already been established between these countries. Many Indian software companies like Infosys have begun to offshore development facilities to China. Likewise China is rapidly expanding into the Indian market with its global brands like Haier and TOL (64). China also enjoys cost advantages over India and others in shipping costs (65).

On the downside the effect of the one child policy is that China is now one of the most rapidly aging countries in the world whilst threats to the environment include air pollution, soil erosion, and the steady fall of the water table, especially in the north.

FDI remains a strong element in China's expansion in world trade and has been an important factor in the growth of urban jobs. More recently there has been an average 2-3% increase in the once unbeatable "China price", a double digit rise in Chinese labour costs, the revaluation of the renminbi and higher oil and energy costs (66).

China is no longer the most cost effective country in the region in some sectors. Beneficiaries of China's rising prices have included textile and garment manufacturers in India, Bangladesh and Cambodia.

Legislation has been proposed to increase workers' rights including higher redundancy payments and increasing collective bargaining. There has been strong opposition from foreign owned multinationals operating in China, threatening to reconsider new investments or suspend current activities in China.

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(63) Goldman Sachs Global Economics Paper 99: Dreaming with BRICs: The path to 2050

(64) Infosys

(65) Confederation of Indian Industry/The World Bank 2002

(66) Li and Fung Group, Hong Kong March 2006

## **EU ACCESSION STATES**

We turn now to look at the new EU member states whose economies have continued to perform significantly better than the original EU member states while attracting strong inflows of investment as a result of their relatively low unit cost levels.

Competition mainly comes from the 8 new Central and Eastern European member states (Poland, Czech Republic, Hungary, Slovakia, Slovenia, Lithuania, Latvia and Estonia) and the 2 other countries from this region, Romania and Bulgaria. These economies are often referred to as 'New Europe'. There are also the small island economies of Malta and Cyprus which acceded in 2004.

### **Investment and trade flows**

Inward foreign direct investment has been a key driver of economic growth in Central and Eastern Europe where in the past 10 years and with accession to the EU, further inflows of FDI into the New Europe economies have been attracted. Total FDI inflows to the EU 15 declined by 40% in 2004 whereas FDI inflows rose by 69% to the new EU member countries over the same period (67). Lithuania, Latvia and the Czech Republic experienced the largest increases in absolute terms. Poland, Czech Republic and Hungary received the most foreign investment whilst in Slovakia, Latvia and Lithuania, equity investments in new projects and privatisation sales were the dominant forms of FDI.

### **Export and trade**

Around 15-17% of exports from Latvia and Lithuania go to the UK, and the UK is Latvia's second largest export market after Germany (68). Industrial structures vary across the ten New Europe economies, but the overall finding is that industrial output (i.e. manufacturing, mining and quarrying, energy and water) accounts for just over 25% of GDP on average in these economies. This ratio is notably higher for the Czech Rep (42%). That said there are important structural differences between each country. Only around 2% of UK trade and 1% of UK outward investment goes to New Europe which raises the question of whether

UK companies are fully exploiting the potential of this fast growing region.

### **GDP growth trends and prospects**

New Europe economies have continued to grow significantly faster than the EU 15. The average GDP growth rate among these ten economies was an estimated 5.9% in 2005 – slightly weaker than the 6.3% growth rate in 2004.

While Poland, Hungary and Slovakia's GDP growth rates are projected to strengthen in 2006, economic growth is expected to slow in the Czech Republic, Estonia, Latvia, Lithuania and Bulgaria and stay relatively stable in Slovenia and Romania. The car industry in Central Europe is still thriving and attracting fresh investments. But some western investors in electronics and textiles are already packing up and moving their factories to China or Ukraine, where labour costs are cheaper.

New member states are now attracting investments in high-tech manufacturing and increasingly also in high-value added services. Nokia and Ericsson are now running R&D centres in Hungary, and the Czech Republic has clusters of Japanese and Korean electronics producers.

### **Productivity and labour cost trends**

New Europe is attracting foreign investors as a result of its low labour costs and productivity growth. Productivity levels (measured as GDP per person employed at PPPs) in the 8 new EU member in the region averaged just over 56% of the EU 15 average in 2004 but hourly labour costs were only around 20% of the EU 15 average. There has been an annual increase in productivity of around 4.8% since 2000, as opposed to an average annual increase of only around 1.1% for the EU 15 over the same period. Unit labour costs have increased since 2000 in all the countries except Poland, Latvia and Lithuania as wages have risen at a faster rate than productivity. However, unit labour cost growth in the New Europe region has slowed significantly since the second half of the 1990s reflecting more moderate real wage growth.

(67) PricewaterhouseCooper

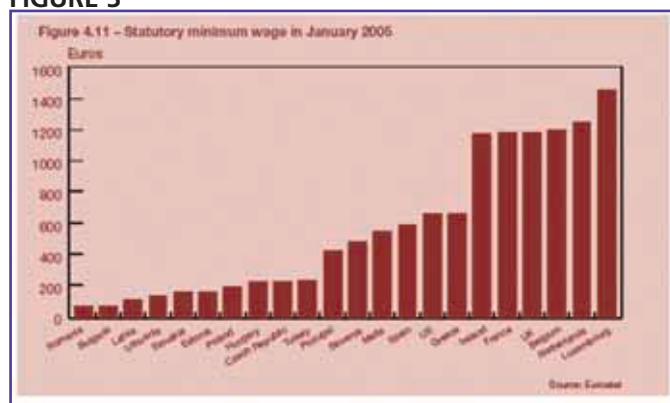
(68) Ibid

(65) Confederation of Indian Industry/The World Bank 2002

(66) Li and Fung Group, Hong Kong March 2006

There are a number of explanations for the trend towards the moderation in real wage growth. Relatively high rates of unemployment in many of the New Europe countries have contributed to lower labour cost pressures – most significant in Poland and Slovakia where unemployment rates have been particularly high. Wage negotiation systems are also likely to have played a role, with most of the new Member States having decentralised wage bargaining systems, and low levels of average trade union membership – 22% of employees against around 33% EU average. However, actual wages are still very low by Western European standards – see figure 3 below.

**FIGURE 3**



### Risks in New Europe

Like many old EU countries, the Eastern European newcomers are struggling to stay competitive in the face of low-cost competition from fast-growing Asia, and are looking for ways to produce more high-tech goods and services and fewer basic manufactured products. Each of the New Europe economies is running a current account deficit. There's little evidence that the large deficits are a result of a loss in competitiveness, with a significant proportion of the deficits in the New Europe economies being due to deterioration in the net investment income balance associated with large FDI inflows. The New Europe economies are also relatively vulnerable to any significant further oil price rises as compared to the EU average they are still relatively oil intensive but are much less oil intensive since the end of the Communist era.

However, if unit labour costs continue to rise, it could eventually strip these economies of one of their principle sources of competitive advantage with investment potentially moving out to lower cost locations further east, such as India and China.

### Lessons for UK Manufacturing

Globalisation has created both challenges and opportunities for UK manufacturing. The evidence and analysis outlined in this chapter identifies the competitive situation faced both now and in the future and Amicus policy must be shaped to ensure that our campaign on behalf of manufacturing workers addresses the real issues.

#### TO THIS END AMICUS IS RECOMMENDING:

- that government ensures that the necessary support and incentives for investment exist. In particular, Amicus emphasises the need to provide support for exporters and funding for small enterprises;
- that government provides exporters with guidance and advice on penetrating new emerging markets;
- that government prioritises investment in Research and Development and the UK science base. Amicus believes that only through advancing economic enterprise and dynamism can the UK forge a lead in safeguarding and delivering high quality manufacturing jobs;
- that companies, operating both in the UK and abroad, should exercise a duty of care irrespective of prevailing local conditions. Amicus recommends the UK government support an international legally binding framework for Corporate Social Responsibility to ensure the maintenance of global labour standards in accordance with ILO and UN Global Compact guidelines;
- that British workers are afforded the same labour rights as their immediate European neighbours (see chapter on Social Policy);
- the UK Government ensures that employee inclusion is paramount in company decisions to relocate operations abroad. Amicus' Offshoring Charter establishes a standard of best practice for companies who wish to reorganise. The Charter provides labour standards for disadvantaged UK workers and those subsequently employed in host countries;
- recognition of International Framework Agreements (IFAs) as a means of improving and protecting labour standards at a global level. Amicus urges the Government to push multinationals to negotiate IFAs with the relevant Global Union Federations.

# UK manufacturing skills

# UK manufacturing skills

## **INTRODUCTION**

The ongoing success of manufacturing within the UK is essential for the future prosperity of the nation. As stated in the introduction to this document, manufacturing currently accounts for almost a fifth of the economy, employing directly around 3.04 million people and many more in associated industries and services. It accounts for 60% of our exports and 80% of spending on research and development.

Yet manufacturing productivity in many other industrialised countries is higher than it is in the UK; around 30% more in France and Germany, and 55% more in the US (69). If UK manufacturers could match performance in these countries, the UK would be £70 billion better off, returns on investments would be higher, jobs better paid, and companies more competitive.

The UK has many world-class companies and real strengths to build on. The UK has an excellent science base and a commitment to cross border trade. However, it also has significant weaknesses. UK manufacturers invest less in capital equipment on average than competitors and generally less on R&D. These factors contribute to the skills shortages and gaps currently being experienced. To compensate for this the UK needs to develop a strategy to develop work force skills that are relevant to the business requirements of the UK economy now and into the future.

There is evidence that global competition is having a significant effect on UK manufacturing. Employers have indicated that they struggle to compete both in the European and global markets. There is also evidence to

show that the competitiveness of US manufacturing is based on the development of a highly skilled workforce evidenced by the proportion of the manufacturing workforce in the US with higher-level qualifications being significantly higher than in the UK. As well as this, the level of the intermediate technical workforce in Germany is far superior to that of the UK. Recent signs of optimism of manufacturing businesses confidence (70) are based on short term business plans rather than a strategic change in the delivery of an up-skilled workforce.

The UK government published a manufacturing strategy in 2002. The strategy focussed on seven pillars, each pillar setting out goals, policies, and roles with future prospects and milestones (71) of the seven pillars. One of the most significant of these pillars is raising skills and education levels. Government aims are to improve skill levels and to exploit investment and new ideas. To facilitate this, government established the Learning and Skills Councils that have overall responsibilities for post sixteen learning in England outside of higher education. The premise is for a major increase in modern apprenticeships, a range of measures to assist existing workforces to raise their skills levels and to enhance the status of vocational and work related learning within the education system.

Government has identified the need for a highly skilled workforce in the UK, yet there is significant evidence to show a considerable mismatch regarding the definition of a highly skilled workforce and the current supply led system of further education provision, the skill needs of employers and government policy regarding the funding of further education and higher education in the UK.

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(69) DTI, *Review of the Government's Manufacturing Strategy*

(70) EEF *Quarterly Outlook Survey September 2006*

(71) *ibid*

## **TRAINING, SKILLS AND EDUCATION IN THE UK**

### **Current strategy**

In March 2005 the government published its second skills White Paper; "Skills: getting on in business, getting on at work". This paper builds on the first White Paper published in July 2003, aimed at developing a strategy for ensuring that employers have the right skills to support the success of their business and individuals gain the skills they need to be employable and personally fulfilled. The skills strategy sets out significant proposals and specific reforms designed to:

- Put employers' needs centre stage in the design and delivery of training through the new Train to Gain programme (72) and employer-led sector based National Skills Academies (73);
- Support individuals in gaining the skills and qualifications they need to achieve the quality of life they want providing a ladder of progression upwards in skills, improve information, advice and guidance;
- Reform the further education sector, allowing the FE colleges to become the engines of social and economic growth, providing young people and adults with the right skills to meet the demands of our economy;
- Develop an improved qualification structure to support both 14-19 and adult education reforms;
- Work with partners to deliver a shared agenda. These include the National Skills Alliance, led by the DfES and DTI, bringing together key partners with an interest in skills and productivity, including the CBI, the TUC and Small Business Council;
- Promote fairness of access for all through crosscutting mechanisms designed to encourage equality of opportunity.

### **Delivery mechanism**

The government believe that the FE system is the foundation for a high skills economy, whilst the funding is biased towards level 2 qualifications. Employers are being encouraged to raise the level of skills within their

workforce to improve performance and increase productivity. The consequence of government strategy is the attainment of lower skills at the expense of higher-level skills evidenced by the Further Education White Paper published in March 2006 which stated "even if we achieve all our current targets for raising skills and qualifications amongst young people and adults, the UK would still end up in 2020 no better than mediocre in the international rankings (74)".

If government is going to achieve its goal of a manufacturing sector based on a highly skilled workforce it has to recognise that the higher education system is fundamental to providing the appropriate and relevant skills, stimulate innovation and support competitive productivity levels. Many of our economic competitors invest more in higher education. Additional resources will be needed if the UK is going to compete globally. Access to higher education must expand to meet rising skill needs and do more to close the social class gap among those entering university.

Centres of Vocational Excellence (CoVEs) (75) have been introduced and will play a major part in providing the vital vocational skills at regional level that the UK economy needs for future success. They focus on delivering vocational skills to meet the needs of employers. Their aim is to produce appropriately qualified and skilled workers with training at level three which meets the needs of the economy. Level two training is largely funded through the Learning Skills Councils whilst level three training is funded by the employer and employee.

National Skills Academies (NSAs) provide an opportunity for employers to set out and invest in developing an approach which meet the needs of their sector. The capital investment required to establish a National Skills Academy comes from a range of contributors. An average of 50% comes from the employers, around 35% from the

(72) <http://www.traintogain.gov.uk>

(73) <http://www.dfes.gov.uk/publications/insapropectus/docs/SkillsAcademiesHi23.pdf#search=%22national%20sector%20skills%20academies%22>

(74) Dfes, *Further Education Reform White Paper: Raising Skills, Improving Life Chances*, p4

(75) <http://www.lsc.gov.uk/NationalIPartners/CoVEsandNSA/default.htm>

government and the remainder comes from other sources and partners such as existing education and training providers. It is anticipated that the National Skills Academies will prioritise those skills that are most important to employers and would be expected to address the full range of skills needs in the appropriate sector, including functional and employable skills, intermediate skills, higher skills and leadership and management skills at level three and above.

A good example of what a National Skills Academy could look like is the Automotive Academy, set up in 2003. The academy comprises of over three thousand businesses of all sizes and is designed to equip people at every level with the practical, management and professional skills that the market place demands to maintain the UK's status as a world leader. Amicus believes the Automotive Academy has been a lifeline for the up-grading of skills within the automotive industry and has created a template for future National Skills Academies to build upon.

### **Qualification**

After a fallow period, where the original apprenticeship scheme, linked to the qualification of City & Guilds was decimated, a new scheme has been implemented. This scheme allows young people and adults to undertake Apprenticeships and Advanced Apprenticeships. They build up practical experience, knowledge and skills, and experience through work based training. This gives the apprentices the opportunity to gain qualifications whilst earning money at the same time. This is a particularly crucial point for adult apprentices who may have families to support.

National Vocational Qualifications (NVQs) are achieved through assessment and training in the workplace. NVQs are nationally recognised qualifications that are accepted by employers and academic institutions. People who complete an Apprenticeship will gain an NVQ Level 2. Advanced Apprenticeships lead to an NVQ at Level 3. Technical certificates focus on the knowledge and understanding that underpins the NVQ competencies and may also cover wider aspects of the chosen occupation or

sector. They prove that the apprentice understands the theory behind the job as well as being able to carry out the practical tasks. However, NVQs are very limited in relation to the developmental opportunities open to workers. They only assess what the worker is doing at the present time, and do not offer any opportunities for a skills or career map to be introduced and implemented. This is a crucial omission in the government's strategy.

Foundation Degrees combine academic study with workplace learning. They are broadly equivalent to the first two years of a degree. They provide a route into university or college for a broad range of students from many different backgrounds. They are designed to provide the specialist knowledge and skills that employers are demanding, as well as the broader understanding that equips graduates for future professional development. The focus is on flexible learning: you can learn part time or full time, or through distance learning, learning in the workplace or learning through the internet. Once a Foundation Degree has been completed, the trainee can progress to a degree with a further twelve to fifteen months of study.

### **Trade union input**

Union Learning Reps (ULRs) have put learning and skills right back at the top of the agenda in workplaces across the country. Working with employers, learning providers and other organisations, they are trained in advising members on learning needs and opportunities ranging from basic skill needs to promoting continuous professional development. Union Learning Reps are providing the opportunity for many thousands of workers to develop new skills or update existing ones.

Analysis of the 1998 Workplace Employment Relations Survey shows that in workplaces where training was negotiated, almost 40 per cent delivered an average of five or more training days a year per employee compared to just over 20 per cent of workplaces where training was only subject to consultation (quoted in *The Learning Curve*, TUC, 2006)

The main functions undertaken by ULRs are set out in the Employment Act 2002 (76) and include:

- Identifying learning or training needs
- Providing information and advice about learning or training
- Arranging learning or training
- Promoting the value of learning or training
- Consulting the employer about carrying out such activities
- Preparation to carry out any of the above activities

### **INNOVATION, RESEARCH AND DEVELOPMENT**

Innovation is seen as the successful exploitation of new ideas. Skills and innovation are mutually supportive since skills underpin the ability to innovate. This in turn increases the demand for better and higher skills (77). Continual investment in skills, training and innovation is essential to gain higher productivity and competitiveness within the global market place.

Research and development can be defined as any project to resolve scientific or technological uncertainty aimed at achieving an advance in science or technology, including improved products, processes and services. Although the UK has a strong science base, UK businesses as a whole invest less in research and development than their main international competitors. Business research and development has increased in real terms in recent years, but has not risen as a share of UK national wealth, as measured by GDP. Latest figures (78) show R&D expenditure remaining at the same level of 1.2 per cent of GDP since 1997, with the manufacturing sector accounting for 77% of the total (79).

Research and development plays an important role in the innovation process and consequently has a symbiotic relationship with the skills and training on offer to

workers. It results in the technology that brings new products and services to the market place or underpins better processes. Innovation can result in high quality jobs, successful businesses, better goods and services and more efficient processes.

There are a number of government initiatives in place to encourage and support businesses to invest in research and development, including tax credits, grants for collaborative projects and Knowledge Transfer Partnerships. Amicus would encourage employers to take advantage of these initiatives especially in relation to the improvement in training on offer to workers.

### **EDUCATION AND TRAINING THE EUROPEAN VIEW**

At the Lisbon Conference in March 2000, government leaders set out a 10 year mission for the EU to become the most competitive and dynamic knowledge based economy in the world, capable of sustained economic growth with more and better jobs and greater social cohesion (80). To achieve this goal the EU decided on an overall strategy that is aimed at preparing the transition to a knowledge based economy and society by better policies for the information society, and through research and development, as well as by stepping up the process of structural reform for competitiveness and innovation.

There is also a necessary adjustment required for those countries of the EU to adapt their education and training systems both to the demands of the knowledge society and to the need for an improved quality of employment and opportunity. A new approach to learning and skills has been designed. The three main components are the development of local learning centres, the promotion of new basic skills, in particular in regard to information technologies, and increased transparency where qualifications are concerned.

(76) <http://www.opsi.gov.uk/acts/acts2002/20020022.htm>

(77) DTI 2006, *UK Productivity and Competitiveness Indicators*, DTI Economics paper No 17.

(78) Office of National Statistics

(79) *ibid*

(80) Lisbon European Council-Presidency Conclusions, 23/24 March 2000  
[http://ue.eu.int/ueDocs/cms\\_Data/docs/pressData/en/lec/00100-r1.en0.htm](http://ue.eu.int/ueDocs/cms_Data/docs/pressData/en/lec/00100-r1.en0.htm)

For the EU, one of the guiding principles for education and training is the adoption and promotion of Lifelong Learning across all the member states. This development encompasses learning for personal, civic and social purposes as well as for employment related purposes. It also includes raising investment in people and knowledge, promoting the acquisition of basic skills and broadening the opportunities for innovation and more flexible ways of learning. The ultimate aim is to provide people of all ages with equal and open access to high-quality learning opportunities and to a variety of learning experiences, throughout Europe. The education sectors of each individual member state have a key role to play in the delivery of these strategic and far reaching principles and the communication from the Commission specifically stresses the need for member states to break down the barriers between different forms of learning.

In the context of globalisation, demographic ageing and the arrival of new information and communication technologies, it is essential for those nation states of Europe that the population is in a position to acquire new knowledge and skills at any time in life. It is vital in economic, social and competitive terms that Europeans are encouraged to engage in higher levels of training and education. For example, there are 150 million citizens in the EU who have not completed higher secondary level education **(81)**.

It is clear that in a world where knowledge and information are paramount, citizens of the EU need new skills to adapt to the ever changing world of work. The way to ensure workers have these new skills is to ensure there is a continuous programme of relevant education and training. This training needs to be demand led as it is imperative that employers have the opportunity to feed in their requirements for worker skills levels and the operational and strategic demands of their workplaces. A fully functioning economic and social society cannot exist without a highly educated and well trained workforce. Education and training are therefore crucial to achieving

the ambitious economic and social goals the EU has set for it to achieve by 2010.

### **HIGHLY SKILLED WORKFORCE**

The UK government has declared that the way forward for UK economic growth in manufacturing is via the creation of a highly skilled workforce. These are workers with a special ability or expertise enabling them to perform a task or an activity very well. The proficiency of carrying out this task or activity is usually acquired through education, training and/or experience. Workers with higher skills levels are able to work more efficiently and effectively and are more likely to generate innovative ideas and enable firms to engage in more sophisticated production processes **(82)**. Improving skills can raise employability, support social cohesion, particularly in conditions of globalisation, encourage new ways of working and enable employers to advance the levels of production and increase productivity.

Skills are developed in a variety of different ways including on-the-job training, coaching, learning-by-doing and also formal educational qualifications. Ideally the measurement of a highly skilled workforce should take into account all of these measures. However, reliable data is only available for educational qualifications, which is used by the DTI as the best available proxy for measuring 'skills'. As far as Amicus is concerned this has not provided a true picture of what is happening in the workplace. The UK performance on workplace skills levels is mixed. By OECD standards the UK has a relatively high level of people with degrees, including those with degrees in Science, Technology and Engineering. However, this falls far short of the levels of people with similar degrees in the US and slightly behind Germany and France.

The main failing of the UK education system is for those people within the intermediate qualification level. This is below all three of the above countries and concerns are often raised about the success of UK vocational qualifications in providing employers with the skilled

**(81)** *Europa Press Release-IP/01/1620*

**(82)** *Bradley and Taylor 1996, Human Capital Formation and Local Economic Performance, Regional Studies, Vol. 30, Issue 1, p1.*

workers they really need. As a consequence this leaves the UK with a large proportion of people with low-level skills<sup>(83)</sup>. This has an acknowledged effect on productivity and the OECD's chief economist made the point that 'productivity in the UK is adversely affected by the poor state of workforce skills'<sup>(84)</sup>.

In the Review of the Government's Manufacturing Strategy, intermediate level is referred to as level 2, (5 GCSEs A\* - C or equivalent), and level 3, (A level or equivalent), while the higher level is referred to as levels 4, (first degree or equivalent), and level 5, (Msc, PhD or equivalent). The Government White Paper on Further Education states that the number of adults in the workforce without skills level 2 for productive sustainable employment in a modern economy is much too high <sup>(85)</sup>. Government policy of placing as many young people as possible into further education, with half of these going on to higher education is all very well providing that the right skills are being delivered. Equally important is the provision for any adults that need it to have the support and training to increase, augment and up grade their existing skills throughout their life. Funding and financial support to achieve this policy must be carefully thought through.

The definition of a highly skilled workforce could easily be accounted for by the levels of educational attainment limited to certain occupational groups. However, the concept of employable skills makes certain distinctions within occupational groups possible. This emphasises the impact of continuous professional development, investment in training and experience achieved through on the job training. A range of technical, practical, generic and IT skills are also considered as employable skills for different occupational groups, for example scientists, engineers, teachers and lawyers. As a consequence of the level of skills requirements for certain occupational groups, situations arise where skill gaps or skill shortages happen.

A skill gap refers to a situation where employees do not have the level of skills required to be fully proficient in their current job roles. A skill shortage means there are vacancies at a company that are hard to fill because applicants do not have the right skills, qualifications, experience or expertise to fill the job role. The UK skills gap accounts for a fifth of the productivity gap with Germany and an eighth of the gap with France. These countries also have ambitious strategies in place to improve their skills base <sup>(86)</sup>. There is a distinct correlation between the skills levels currently achieved by the UK workforce and the prevalence of skill gaps and skill shortages.

The vision of a UK manufacturing sector made up of highly skilled, knowledge-intensive, highly productive, innovative manufacturing businesses can only be achieved if all the stakeholders, government, business, trade unions and academia work together towards a common goal <sup>(87)</sup>. The main challenge of developing a highly skilled workforce, is the availability of education, training and on-the-job learning opportunities that will resolve the problem of skill gaps and skill shortages, as well as providing a platform for continuous improvement and personal development. The Department for Education and Skills (DfES) noted in the Future of Higher Education (2003) document that in a fast changing and competitive environment, the role of higher education establishments in equipping the labour force with appropriate and relevant skills was never more crucial.

The UK has unique advantages that could be exploited to maintain and increase its position in the global economy. The current UK economy provides an enabling environment for a thriving manufacturing sector. Within this environment the requirement for lower grade skills has declined over a number of years. However, this does not mean that those skills should be lost for ever and never needed again. The need for generic skills like

<sup>(83)</sup> DTI, 2006. *UK Productivity and Competitiveness Indicators*, DTI Economics Paper No. 17

<sup>(84)</sup> TUC-2020 vision for skills, p. 7.

<sup>(85)</sup> DfES, *Further Education Reform White Paper: Raising Skills, Improving Life Chances*, p 64<sup>(86)</sup> TUC-2020 vision for skills, p 7.

<sup>(87)</sup> DTI-Review of the Government's Manufacturing Strategy, *Competing in the Global Economy – the manufacturing strategy two years on, 2004*

communication and team working indicates that it would be appropriate to assume that a highly skilled workforce will always need workers of a lower skills level, but with the necessary generic skills to support them. This could also be true for the supply chains needed to support the larger manufacturing industries. It is well known that for many large manufacturers there are at least double the amount of workers who work outside of the main employer but are dependent on the work from that employer. These too may consist of a mix of different skills levels but are an essential part of the supply chain and ultimately the productivity and profitability of the company.

The UK government has clearly indicated that their manufacturing strategy is designed to create a globally competitive manufacturing sector, focussed on the production of high value goods and services, and employing a highly skilled and flexible workforce. The success of this strategy however is dependent on how the government transposes its training and education policies into the reality of the world of work. At present the delivery of further education courses, which are the central plank of government provision for the manufacturing sector, is supply led and not demand led. UK employers have said time and again that they need to be involved in the decision making process regarding the vocational courses on offer and this is not happening. Huge amounts of funding are going to the further education sector for the provision of vocational courses, at the expense of the higher education sector, which is currently being starved of funding and where the number of students opting to take science based degrees is at an all time low. There is an obvious mismatch of what is on offer and what is required by manufacturing industry.

Unfortunately, there is a view that this is not being addressed by the relevant Sector Skills Councils (SSC's). At a recent seminar, a survey of 100 manufacturers indicated that as far as they were concerned SSC's were nothing more than government quangos with little or no impact on the lack of skills in the manufacturing sectors (88) .

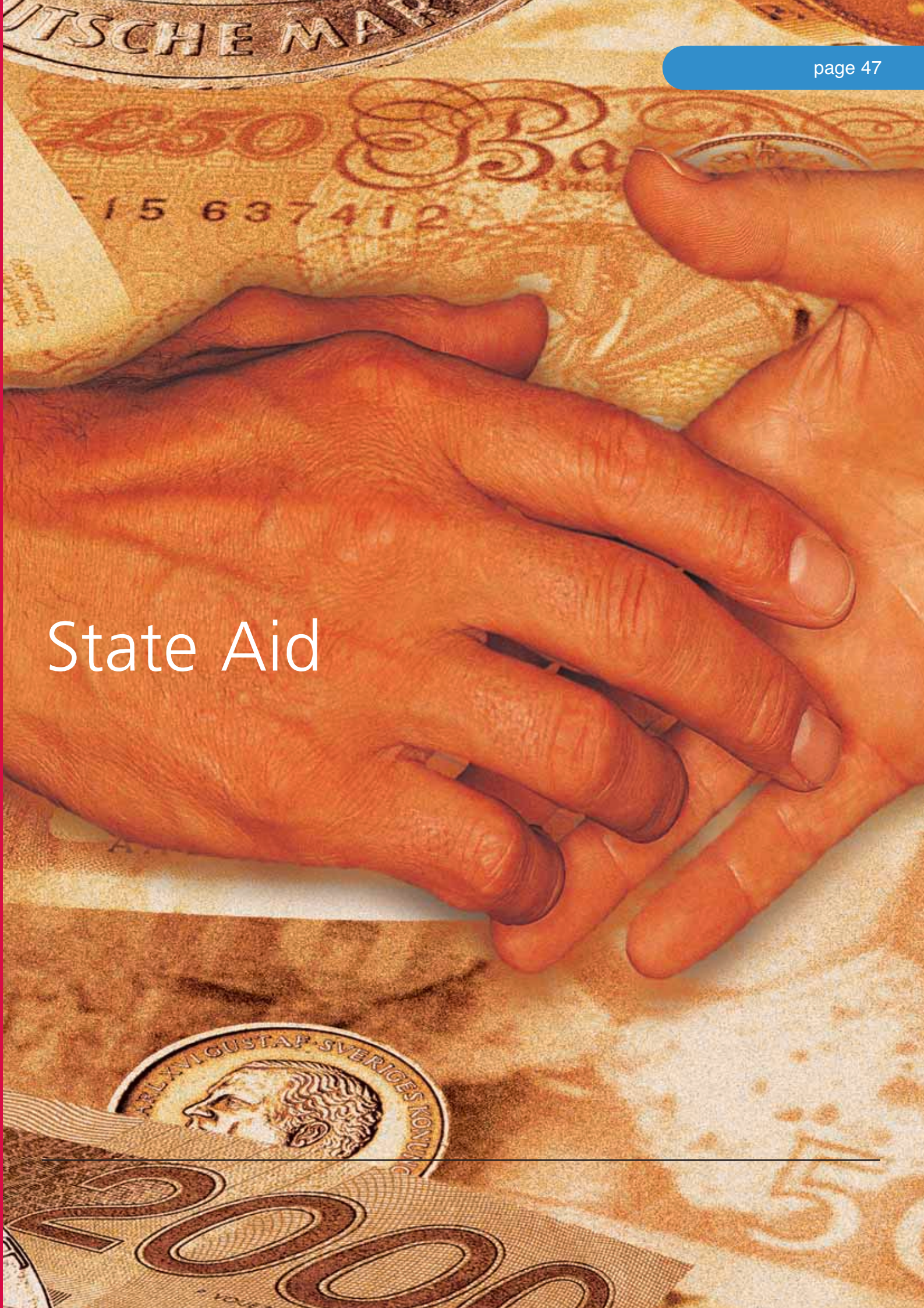
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(88) *The Manufacturer-August 2006, Vol 9, Issue 8, p.10*

## AMICUS RECOMMENDATIONS

1. There needs to be a significant re-direction of funding. At present the majority of funding is directed at FE, to the detriment of HE. If the Government wants to continue in this vein then there needs to be a review of the delivery of training from FE to ascertain whether it is effective;
2. The mismatch between the skills training provision that is on offer and what is required by employers must be reviewed. There needs to be an open and frank debate including all the stakeholders to ensure that the training on offer is what is required by manufacturing industry;
3. There needs to be a substantial marketing exercise regarding the value of working within manufacturing and acquiring the skills, education and training to facilitate this. More young people need to be encouraged to go into courses that are science, mathematics or technology based;
4. The work of the Sector Skills Councils has to be subject to a system of quality control if the criticisms of users are to be overcome;
5. ULRs have done a great deal to increase basic skills and open up educational and training opportunities to workers and the current union learning rep programme needs continuing funding;
6. Government should match its commitment to training and acknowledgement of the contribution made by ULRs by including training in the collective bargaining rights legislation;
7. There needs to be a detailed analysis of the learning and skills requirement for specific sectors which would include a skills matrix and a career map for specific workers. This would enable career paths to be plotted and enable employers to see what training needs to be provided.
8. The UK government needs to show a consistent and cohesive approach to education and skills in the UK. At present each new minister brings in different initiatives and reforms, none of which seem to be demand led. Supply led training provision is not acceptable and will not deliver a sustainable manufacturing sector in the future.
9. Learning needs to have a much higher profile, both in terms of image and by providing incentives for the people most reticent to learn to opt for training. This would introduce a culture of learning, building on the EU argument for a knowledge based economy by 2010.

# State Aid



# State Aid

## EUROPEAN TRENDS IN STATE AID

Governments increasingly compete aggressively to attract and promote business by offering subsidies and tax breaks, however the incentives offered differ from country to country. During the 1990s, for example Austria and the Netherlands provided subsidies for R&D, Portugal, France and Ireland focussed on aiding specific sectors, and Belgium and Italy channelled resources into developing regions.

How and when subsidies are used is affected by the electoral institutions and party politics occurring in a particular country. Factors such as the level of clientelism and porkbarrelling or left/right party politics will affect how and where aid is spent (89).

Subsidies began as a response to trade liberalisation during the 1960s but have evolved into a number of measures. During the 1970s subsidies became available for declining industries such as metals and shipbuilding to direct activity towards national specialisation in sectors such as aerospace. From the 1980s onwards there has been a shift towards demand controlling policies (such as those used in the US) and horizontal objectives (favoured by the EU) and a move away from supporting traditional industries, which are perceived to be in decline.

Horizontal objectives refer to subsidies for research and development, improving employment rates, providing aid to SMEs and other measures which are not seen to be in conflict with the single market and inter state competition. The EU also stresses the need to reduce the gap between rich and poor regions and therefore the importance of regional subsidies. A preference for horizontal measures was first seen in the UK from the late 1970s onwards before adoption by Sweden and Denmark in the 1980s and then France, Italy, Portugal and Spain during the 1990s. There have also been international attempts to control subsidies running in tandem with the European trend, such as GATT and WTO.

Aid instruments vary across Europe. During 2002/04, grants were used to provide aid to manufacturing and services in the EU. Grants are the preferred instrument of countries such as Belgium, Denmark, Luxembourg, Estonia and Austria. These countries provide at least 85% of aid through grants. Soft loans or tax deferral are preferred in the UK, representing 10% of aid to manufacturing and services.

## EUROPE AND THE UK

### **State aid in absolute and relative terms**

The EU has taken significant steps to tackle the amount of aid being used by member states to support their resident industries. The rationale of EU reforms on state aid has been to improve European wide competitiveness internationally and in the internal market. The European State Aid Scoreboard Report (2005) confirms this trend of replacing specific industry aid with horizontal measures.

The overall level of state aid granted to the 25 member states in 2004 was €62 billion (estimated). This represents 0.6% of GDP. The top recipients of aid were Germany (€17 billion), France (€9 billion) and Italy (€7 billion).

The reasons for increases in state aid vary across countries. In France the increase is in part accounted for by the restructuring process undertaken at Alstom in 2004. The Polish coal industry received an exceptional award of aid in 2003 and in Sweden and the UK rises in the level of aid are largely due to the prioritisation of horizontal objectives such as the environment.

In addition, as the EU Commission report states (90) "it is important to bear in mind that some aid measures cannot be quantified. Although the number of measures is limited, the distortion of competition is often very significant and has an impact on the overall level of state aid". The report goes on to mention the unlimited state guarantees previously made available to EDF in France and the German Landesbanken.

(89) *Politics of State Aid in the EU: Subsidies as Distributive Politics*. University of Washington

(90) *EU State Aid Scoreboard Report Autumn 2005*

### Unlawful aid

In the vast majority of cases (89% in 2005) the EU approves the award of aid. In such cases the Commission concludes that aid is compatible with state aid rules and no formal investigation takes place. In cases of doubt, the Commission conducts a formal investigation and takes a positive, conditional or no aid decision. No aid decisions occurred in 8% of cases in 2005. Negative decisions, where the Commission rules that a measure contravenes state aid rules occurred in 3% of cases in 2005.

If there has been an unlawful award of aid the Commission must recover the funds. At the end of 2005 there were 75 such cases (91). Germany has the most pending recovery decisions (35%), followed by France and Spain, together accounting for 53% of cases. Recovery of unlawful aid is a lengthy and complicated process and may involve bankrupt businesses.

### Trends towards the use of horizontal objectives

By adopting the principle of 'less and better targeted aid' the EU has reduced and stabilised levels of aid provided across the region. In 2004 90% of aid awarded in half the member states was for horizontal objectives. However, this does not hold for all countries - in Spain, France and Ireland the figure is considerably less for 2004 at 60%. The low share of horizontal aid in France is in part explained by the assistance given to Alstom during restructuring.

In countries where horizontal objectives have been prioritised improving the environment and aid to SMEs has featured highly. In Sweden aid to the environment and energy saving constitutes 88% of total aid and in Denmark and the Netherlands the figures are 54% and 52% respectively. 39% of aid in Italy, 38% in Belgium and 34% in the UK is used for SMEs. The EU average is 15%. Assisted areas account for 27% (€12.3 billion) of total aid in the EU (2004 figures).

### Research and Development

Leading the way in research and development spending

are the Netherlands, Finland, Austria, Estonia, Czech Republic and Belgium. State aid to R&D in these countries is more than twice the EU average (12%).

The EU Commission report on the State Aid Scoreboard (Autumn 2005) states that "Investment in R&D is a crucial factor to make the EU economy competitive and to ensure sustainable growth". Despite the UK allocating 21% of its aid towards R&D initiatives, this figure still only represents 0.04% of UK GDP. Based on the current levels it is unlikely that EU targets on funding for R&D will be achieved by 2010 and therefore the EU has identified R&D aid spending as a priority.

### Alternatives to State Aid Instruments

A number of European countries have taken steps to develop alternative measures to encourage industry that avoid EU state aid sanctions.

In Sweden and Denmark there is a focus on improving the general environment and growth conditions of firms, rather than providing aid to individual firms. In Poland, the state encourages development through technology parks and clusters and business consultations, for use by SMEs. Whilst such initiatives may not be exactly what is needed in the UK, it is similar alternative measures which the UK government needs to explore to provide maximum benefit to UK manufacturing.

### Future EU Developments

In 2005 the EU Commission launched a State Aid Action Plan. The aims of the Action Plan are:

- The formation of guiding principles for a comprehensive reform of state aid rules and procedures over the next 5 years (expected 2006)
- The adoption of a new R&D and innovation framework (expected 2006)
- The production of Environmental Aid Guidelines (expected 2007)
- The introduction of a general block exemption regulation (expected 2007)

## **THE UK POSITION ON STATE AID**

### **Distribution of aid in the UK**

The DTI estimates that in 2006, £150 million will be spent on state aid projects in the UK. Regional state aid accounts for less than 20% of total UK state aid. The vast majority of aid is aimed at horizontal objectives. Horizontal objectives include R&D aid to encourage competitiveness, aid to improve access to training, access to venture capital for SMEs, employment aid for recruitment of disabled or disadvantaged workers and regional aid to SMEs.

### **Assisted areas**

Assisted areas are regions of the UK that have relatively low levels of economic activity and high unemployment, often resulting from a decline in traditional manufacturing. The EU advises that Assisted Areas are defined by comparison of these areas with UK averages under ILO indicators for unemployment, employment, claimant count unemployment and manufacturing share of employment.

Regional development, according to the DTI, is about improving the economic performance of all regions and to reduce the persistent gap in growth rates between regions. Currently productivity varies widely between regions, as do levels of employment.

Assisted area status does not automatically bring funding to these regions. Instead it offers eligibility for certain forms of financial support and enables the government to provide large scale investment to firms in these areas.

### **Selective Finance for Investment in England**

The purpose of this investment is to fund new projects that lead to long term improvements in productivity, skills and employment. This is made available to businesses operating in Assisted Areas. Funds are provided by the DTI.

Support is discretionary and can take the form of a loan or grant with the minimum grant available of £10,000 upon meeting specified criteria, judged by Regional Development Agencies. It is available to businesses of all sizes and funds can be used for starting a new business,

modernising, expanding and reorganising existing businesses, making technological improvements or investing in innovation and developing a new product or process from inception to production.

### **Restrictions to the availability of Selective Finance for Investment**

Support is only available for businesses investing in manufacturing or for service industries which operate nationally (not just to a local market). Applications for funding must come from companies, partnerships or sole traders.

Funding must be used for capital expenditure on fixed assets, such as property or machinery, although patents or professional fees may also be covered. Financial support may also be available based on, but cannot be directly used for, wage costs. In effect, support is available for businesses demonstrating job creation potential. To be eligible for funds in excess of £100,000 a project must create new jobs or protect existing employment.

Projects are assessed according to their profitability, competitiveness and investment in skills. Projects must also be innovative and knowledge based and the majority of jobs created should be at NVQ Level 2 or above.

### **Innovation**

Projects designed to create innovation can also gain funding through a number of measures:

- All businesses are eligible to take part in 'Knowledge Transfer Networks' which provide grants to facilitate joint working between businesses, universities and others with an interest in technology.
- All businesses are also able to make use of 'Knowledge Transfer Partnerships' which provide grants to cover part of the cost of using a person to transfer and embed knowledge into a business.
- All UK based businesses can get funding for collaborative R&D projects with universities and other organisations.
- Small businesses can apply for Research and Development Grants and Grants for Investigating and Innovative Idea.

### Manufacturing Advisory Service

The MAS was set up in 2002 to provide independent advice for businesses at subsidised rates, or in the case of small businesses, for free. The service is staffed by manufacturing experts who provide bespoke help and advice for individual firms operating in England and Wales. Advice is available from regional centres as a first point of contact. MAS assistance is targeted at improving factors such as productivity, efficiency, reduction of waste and use of space.

### Learning and Skills Councils

These are the regional organisations which deliver the funding for training people over the age of 16. The funding is paid to employers.

### Small Firms Loan Guarantee

This is for small businesses which are unable to obtain commercial loans because of a lack of security. The government provides a guarantee covering 75% of the loan to encourage commercial lenders to invest in the business. Borrowers pay DTI a premium of 2% p.a. in return for the guarantee.

### Regional Venture Capital Funds

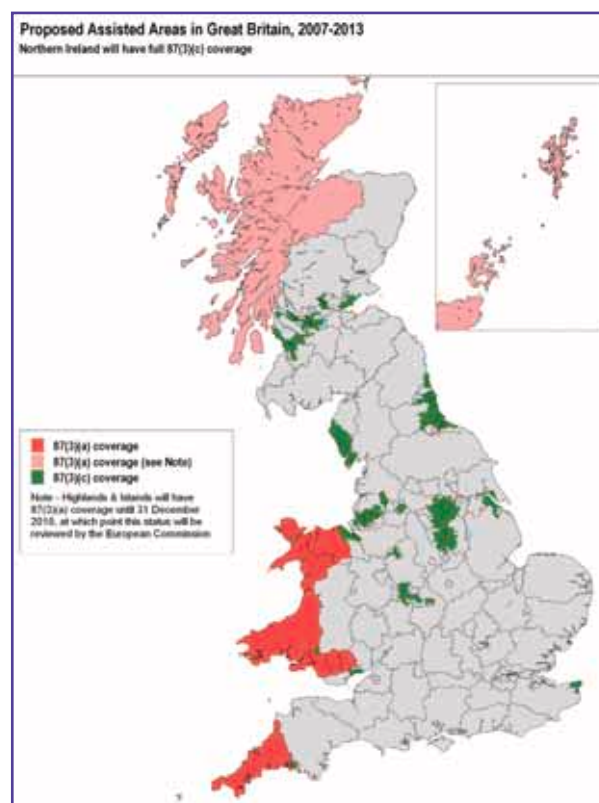
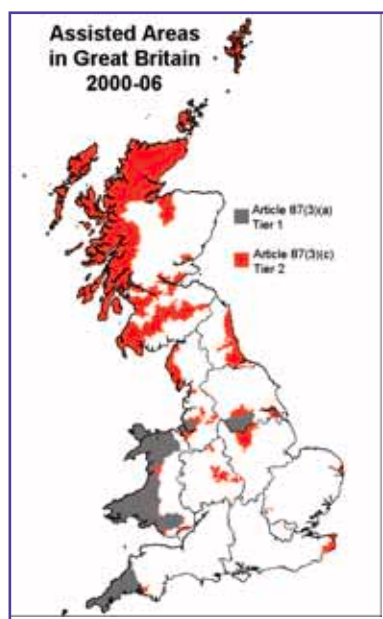
RVCFs have been set up to address the 'equity gap' encountered by many small to medium sized businesses that are looking for venture capital investment of up to £500,000. The funds are managed by experienced venture capital professionals on commercial terms. There is a fund in each of the English regions and a total of £250.5m is available (DTI 2005 figures)

### English Partnerships

This is the Government's national regeneration agency, responsible for improving growth in England. The agency chooses a number of strategic sites for development and ensures that surplus public sector assets are used.

### Changes to assisted areas map from 2007

The European Commission decides on Regional Aid Guidelines for member states who in turn draft assisted areas maps. The current assisted areas map will change at the end of 2006. The new map will run from 2007 – 2013 .



The proportion of the UK population included in assisted areas will drop from 30.9% in 2006 to 23.9% in 2007. This is because of the recent good relative performance of the UK economy, the EU agreed principle of 'less and better targeted state aid' and the impact of the accession of the 10 new member states in 2004, requiring a redistribution of aid to the newer and poorer EU member states.

Merseyside and South Yorkshire will lose complete coverage through the proposed changes, retaining only 81% and 76% coverage respectively.

#### **ECONOMIC ARGUMENTS FOR STATE AID POLICIES**

Whilst purely protectionist policies can work against economic nation states there are sound economic reasons for the State to provide assistance aimed at developing its own economy. This is particularly the case where mature industries need to innovate and diversify or where there needs to be encouragement for strategically important industries to expand to meet current and future needs to ensure comparative advantage. This equally applies to ensure the protection of industries integral to national security and defence.

Sustaining employment in specified geographical regions or where there is a strategic need for skill retention are strong arguments for government support and where the market fails to protect key industries then state aid can provide a buffer.

There are circumstances where countries must be able to protect themselves against protectionist policies of other states and in such circumstances the provision of state aid can be economically justified.

Amicus has consistently argued for the Regional Development Agencies in England and the Scottish and Welsh Agencies to be mandated to promote and boost manufacturing industry and has argued to protect Northern Ireland's "special status" within the EU. It is

now established that each development agency must include a strategy for manufacturing but there remains much more to be done in terms of delivery.

The key argument surrounding state aid remains the apparent disparity between the attitude adopted by UK government and that of a number of immediate European competitors. As is referred to elsewhere in this document, the approach to "strategic" industries and the use of positive procurement policies almost as a form of state aid is markedly different to the UK approach which relies exclusively on the market and adheres to the strictest interpretation of EU rules on state aid. This aspect of the absence of a 'level playing field' hits at UK manufacturing particularly hard.



# Social Policy – a level playing field

# Social Policy – a level playing field

## **INTRODUCTION**

Whilst many commentators point to high labour costs and low productivity as the reasons for the decline in UK manufacturing, recent research has challenged the theory that a more flexible labour market is the answer to the problem. In this chapter we look at the impact of the employment flexibility introduced by the government into the UK and pose the question – how do you reconcile the decline in manufacturing jobs in the UK with the advent of one of the most flexible employment structures in Europe and wider afield?

We also examine the approach to industry by national governments and the factors which determine corporate decisions for investment and location of production facilities.

Finally, we look at the value that UK manufacturing places on its social responsibilities and what trade unions should be doing to raise their game when it comes to influencing corporate social responsibility.

## **CURRENT STATE OF PLAY**

A positive social policy helps improve economic performance. This is not just trade unions promoting their own agenda but is a recognised component part of measuring the value of a company. In a paper published in January 2006 by The Institute of Manufacturing (92), the value of a modern manufacturing company was described as:

*“..When thinking about value it is easy to assume it is the same as profit or revenue. However, a firm’s value goes beyond its financial performance and includes social impact and strategic importance to the regional and national economy.”*

A joined up approach by the social partners to resolve problems is the best route to success. Social partners should be involved through genuine social dialogue, creating European and global level discussions between employer representatives at company and sector level and their workplace representatives. Amicus has called upon the UK government to support an international legally binding framework for Corporate Social Responsibility to ensure the maintenance of global labour standards in accordance with ILO and UN Global Compact guidelines.

Amicus believes that the internal CSR agenda which relates to employment issues should be given a stronger focus by employers. For Amicus this means more than rhetoric and should go beyond good public relations. As far as Amicus is concerned it is on the tangible benefits for employees that an employer’s real commitment to CSR should be measured and in particular the treatment of employees at a time of company restructuring.

UK manufacturing operates in a global environment within UK regulation. As has been described in previous chapters, much of the sector is owned by global corporations whose commitment to individual nation states is of a limited nature. In a global capitalist market the first concern of the manufacturer is to its shareholders and investors. It is therefore important that nation states employ strategies which ensure that key industries are given some protection from the market freedom of the employers.

Contrary to this approach, the UK Government has consistently weakened the comparative ability of UK workers to defend manufacturing jobs to those rights enjoyed by workers in Europe and beyond. This is not simply a question of employment rights enshrined in legislation but is also a question of attitude. When Carl-

Peter Foster, President of General Motors Europe can openly state that a decision to make UK workers redundant in Ellesmere Port is because "...Britain's more flexible labour market" made job cuts easier in Britain than elsewhere, it is time to look at the so-called benefits of a flexible labour market.

When comparing employment flexibility in the UK with our main competitors in the EU accession states and BRIC, the following data from the World Bank makes interesting reading. Despite lower unit labour costs, these competitors have more rigid labour structures than the UK.

As the chart below shows, the UK has the lowest 'Rigidity of Employment' Index score of the selected countries – this is an average of the indices for difficulty of hiring,

rigidity of hours and difficulty of firing. In addition, the indices appear to suggest that:

- It is easier to hire workers in the UK than in the BRICs or in New Europe
- It is easier to fire workers in the UK than in the BRICs or New Europe
- It is easier to determine working hours in the UK (and the Czech Republic) than in the rest of New Europe or the BRICs

It therefore appears that for the time being, New Europe and the BRICs are competing with the UK solely on unit labour costs and not on the basis of a flexible employment regime.

**TABLE 9**

Country	Year	Employing Workers					
		Difficulty of Hiring Index	Rigidity of Hours Index	Difficulty of Firing Index	Rigidity of Employment Index	Hiring cost (% of salary)	Firing costs (weeks of wages)
AVERAGE	2005	35.9	56.0	38.0	43.3	27.4	48.8
Brazil	2005	67	80	20	56	26.8	165.3
Bulgaria	2005	61	60	10	44	32.2	29.8
China	2005	11	40	40	30	30.0	90.0
Czech Republic	2005	33	20	20	24	37.0	21.6
Estonia	2005	33	80	40	51	33.0	33.2
Hungary	2005	11	80	20	37	33.5	33.5
India	2005	56	40	90	62	12.3	79.0
Latvia	2005	67	40	70	59	22.4	17.0
Lithuania	2005	33	60	40	44	28.0	33.8
Poland	2005	11	60	40	37	25.8	24.9
Romania	2005	67	60	50	59	34.0	98.0
Russia	2005	0	60	30	30	35.8	16.6
Slovak Republic	2005	17	60	40	39	35.2	12.9
Slovenia	2005	61	80	50	64	16.6	43.0
United Kingdom	2005	11	20	10	14	8.7	33.5

Neither do stricter employment protection laws adversely impact on productivity. France, Netherlands and Germany, where workers all enjoy significantly better protection, are also able to match and beat the UK when it comes to productivity performance.

In 1994 the OECD produced its Job Strategy (93) against a background of relatively high unemployment. In Europe the lead was taken from this influential strategy paper to make employment contracts more “flexible”, cut benefits and reduce market regulation. More recently, the widespread conviction that low levels of employment regulation and weak trade unions are the cause of Britain’s good record at creating jobs and keeping unemployment down has been exposed as a myth. A new study by The Work Foundation (94), argues that several European countries (Denmark, Sweden, Austria and the Netherlands) have achieved comparable or better levels of labour market dynamism to the UK - while at the same time allowing for much greater levels of “workplace justice”. The study also takes aim at the assumption that “being more like America” is essential if high levels of unemployment in some continental European countries are to be reduced.

In the UK and USA, the idea that deregulation equals high employment has been allowed free reign despite the overwhelming evidence that countries with very different laws and institutions have performed just as well economically, have less wage inequality and a higher quality of working life for their citizens. Interestingly the study calls for a series of specific reforms, aimed at improving the level of ‘workplace justice’ offered in Britain which reflect the campaigning aims of Amicus. They include:

- A higher level of compensation for redundancy
- Reducing the qualifying period for a redundancy payment
- A review of the penalties and sanctions imposed on employers who fail to properly inform and consult about threats to employment and redundancies
- The development of “sector forums” in low pay, low skill,

low productivity industries to improve productivity and increase pay

- The introduction of an effective 48 hour limit on the average working week

The OECD’s own review of its Jobs Strategy also accepts, albeit less enthusiastically, the existence of an alternative model to its own liberal position in 1994, based on a decade of experience (95).

### **THE ‘LEVEL PLAYING FIELD’**

It is more than a catch phrase; it is the plank upon which much of what is needed to secure a viable future for UK manufacturing is based. Our analysis of employment legislation, state aid, the application of the social model and national support for strategic industries across Europe (96) demonstrates the disadvantages faced by British workers when in direct competition with other European production plants for the investment needed to achieve productivity levels to ensure new business comes their way.

The most recent evidence of this imbalance was the decision of Peugeot-Citroën to announce the closure of a viable, profitable plant in Ryton, Coventry and move future production to a new factory in Slovakia. To contemplate a similar action to one of the company’s factories in France would be unthinkable and simply would not happen. Similar closures and transfers of work are a daily diet for the manufacturing sector in the UK and whilst it cannot be argued that these factors alone are responsible for the decline seen over recent years, the absence of equal status at least at European level adds to the barriers that UK workers have to face.

Why do we argue that the European Social model should be applied in the UK? In the following sections we describe what we mean by the “Social model”; destroy the myths surrounding it and highlight the effects and comparisons between the rest of the EU and the UK.

(93) *The OECD Jobs Study June 1994*

(94) *‘Who’s Afraid of Labour Market Flexibility’ David Coats*

(95) *Boosting Jobs and Incomes – Policy Lessons from Reassessing the OECD Jobs Strategy 2006*

(96) *Correcting the Balance – Amicus April 2005*

### **WHAT IS THE EUROPEAN SOCIAL MODEL?**

There is no single, pan European social model. European economic and social policy debates have long split member states into three broad groups (97):

- Those in favour of free and flexible labour markets, less regulation and more competition (countries such as UK, Ireland, Slovakia, Estonia and Italy). These countries tend to advocate the Anglo-American model of leaving labour market adjustment to the machinations of the private sector.
- A number of continental European countries tending to favour higher social standards, regulated markets, labour market protection policies and more rights for workers (e.g. France, Belgium, Hungary and Germany).
- Scandinavian countries that combine relatively flexible labour markets with public sector participation in the adjustment to labour market changes.

There are also some countries which operate a neutral/mixed labour market policy – such as the Netherlands and Slovenia.

Attitudes towards state intervention also have an effect on expenditure on unemployment and retraining provisions. Spending on unemployment insurance and retraining account for only 0.5% of GDP in the US, whereas in France and Germany the figure is 2.95% and 3.5% respectively (98).

As an institution, the EU has only limited powers in the areas of employment and social policy. National governments still determine the majority of social and employment policy for their states. Much of what the EU does can be referred to as 'soft policy' e.g. the promotion of best practice through comparisons of employment, pension provisions, social inclusion and poverty rates across member states. However, the EU is powerless to enforce best practice.

The broad groupings in Europe clash over the small number of powers the EU does have to make laws in the social area, such as legislation concerning anti discrimination, gender equality, health and safety and working conditions. Current and future EU proposals on regulating temporary work, 'portability of pensions' and a revised working time directive continue to stir up such divisions.

Despite its limited powers, the EU has been able to counteract some of the effects of the UK's predilection for flexible labour markets, privatisation and competition, through such areas as information and consultation rights and parental leave.

### **MYTHS ABOUT THE EUROPEAN SOCIAL MODEL**

Comments are made on a regular basis that the UK economy, and manufacturing in particular, would suffer if the European social model were to be introduced here. Some of the most common arguments are set out below with facts to dispel these myths.

#### **• Social Europe cannot provide decent pensions**

Europe is perceived as having enormous problems with pensions whereas in fact it is a worldwide problem. In Anglo-American economies manufacturing jobs are, in part, threatened by the need to mend large pension fund deficits. In December 2004 these deficits totalled \$350 billion in the US and £65 billion in the UK (99).

Blackburn (100) states that companies such as Boeing, American Airlines, US Steel, Unilever, BT and GKN have deficits in their pension funds worth more than half the value of the corporation itself. In order to cut the deficit, firms have chosen to cut jobs. Furthermore, during times of favourable market conditions employers have taken contribution holidays. Between 1998 and 2001 British companies missed £28 billion in pension contributions.

(97) See *Ranis and Corderi: When Labor Loses Out to Trade YaleGlobal Online 2006*

(98) *ibid*

(99) See *Robin Blackburn: Social Model in Europe. New Left Review 34 July – August 2005*

(100) *ibid*

European companies are required to put away more money during good economic periods. They are also likely to be part of pension conglomerates, either industrially or regionally determined. In this way, pensions are not dependent on the fortunes of one particular company. At the same time Europe has performed better at preserving manufacturing employment.

- **Social Europe is not as rich as the US**

It is often said that people living in the US are richer and experience a much better quality of life. It is true that the US has a higher GDP than Europe. This is due in part because a higher proportion of Americans are in employment and they tend to work around 20% more hours per year than Europeans (101). However, GDP per person per hour worked shows that there is no difference between France, Germany and the US (102).

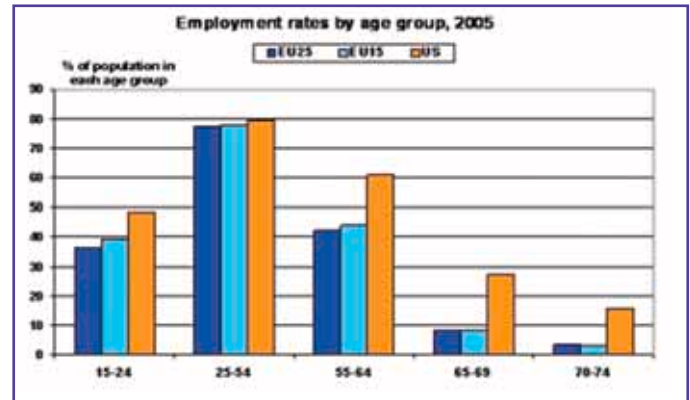
- **Growth rates are higher in the US**

Furthermore, taking into account immigration rates over the past decade and the resulting population growth in the US, GDP growth rates and labour productivity growth are the same for the US and EU (103). In addition, US gains in productivity are made in distribution, not in the manufacturing sector.

- **Employment is higher in the US**

The US experiences better levels of employment and unemployment but it is worth looking more closely at the composition of the employment rate. Comparing employment rates in 2005 shows that in the 25-54 age group there is virtually no difference between the EU and US. Differences in employment rates are concentrated at the extremes where the US demonstrates higher rates of youth and elderly employment.

**FIGURE 4**



*Source: Terry Ward, Alphametrics, Cambridge and Brussels, 2006*

Lower rates of employment among older and younger workers in Europe are not simply because there are not enough jobs. It is more likely that Europeans in the 15-24 group will be in education, or will not be working because of better funding for further and higher education. Lower employment of older workers can also be explained by more robust pension provision in European countries, especially among lower socio-economic groups who would otherwise find it more difficult to save for retirement. This group is more likely to carry on working in the US.

- **Flexible labour markets are better at tackling unemployment**

There is a perception that economies such as the UK and US have been more successful at tackling unemployment and long term unemployment in particular. It is true that the length of time that a displaced worker spends unemployed is likely to be shorter in these countries than in continental European countries, however this statistic merits qualification. Re-employed workers in the US and UK are more likely to incur wage losses than those in Europe. The proportion of workers who experience a wage drop of 3% or more on returning to work in the US is 22%, while in Europe the figure is 8% (104).

(101) See George Irvin (SOAS): *Europe v USA, Whose Economy Wins?* [www.federalunion.org](http://www.federalunion.org) June 2006

(102) *ibid*

(103) *ibid*

(104) See Ranis and Corderi: *When Labor Loses Out to Trade* YaleGlobal Online 2006

The UK has one of the most flexible and least regulated labour markets in the world, according to the EPL (Employment Protection Legislation) Index calculated by the OECD. This flexible labour market is credited with being one of the reasons why the UK has been able to tackle unemployment effectively.

However, experience in other European countries demonstrates that it is possible to cut unemployment without compromising employment standards. In the past ten years activity rates in Spain have increased by 8% and the unemployment rate has dropped by 10 points (according to CEPREDE). In 1995 the unemployment rate in Spain was about three times higher than the EU 15 average. Now it is nearer the average and close to French and German rates. Spain's GDP is only 7% of the EU 15 but it accounts for one third of job creation in the EU. 4.3 million jobs have been created since 1997, 2.2 million of which directly or indirectly involve the expansion of the construction sector (105).

• **We need flexible labour markets to compete with emerging economies**

Emerging economies such as Brazil, India and China are increasingly opening up to trade and there is a concern that Europe should cultivate a more flexible labour market in order to cope with competition from lower wage cost countries. This ignores the fact that a number of emerging economies have relatively inflexible labour markets. Competition in the international labour market is currently driven by unit labour cost. Countries such as the UK already have a competitive advantage in terms of labour market flexibility but this has not prevented job losses to emerging economies with more rigid labour market systems. This should not be misinterpreted as an argument for a race to the bottom in terms of unit labour costs, as it is likely that with further development, wage costs will rise in emerging economies.

**EFFECTS AND COMPARISONS – UK -V- REST OF EU**

So what are the realities when we look at the performance of the UK measured against that of the rest of the EU? How has the UK fared as a result of its flexible labour market and lack of a social model?

**Manufacturing**

- Since 1997, 1,045,000 manufacturing jobs have been lost in the UK (according to the National Statistician).
- Between June 1997 and the end of 2004, the UK has lost 22 per cent of its manufacturing jobs. In France and Germany, the loss has been between five and six per cent.

**Redundancies**

- Redundancies are handled very differently in the UK than elsewhere in the EU, making it easier and cheaper to sack UK workers than their European counterparts.
- Minimum redundancy pay in some EU countries is almost five times that in others

**Information and Consultation**

- In the UK, the employer controls the redundancy process. Consultation takes place dependent on how many are due to be made redundant, i.e. once the decision has been made
- In France and Germany employers and workplace representatives must agree on how redundancies are handled through real consultation and in France they must even make the case that they are necessary at all.

**Social Plan**

- French and German employers must provide further help for those facing the sack - in some cases agreeing a "social plan" with further compensation, training and development provisions, and placing employees in new jobs.

### **EU EMPLOYMENT LEGISLATION IN THE UK - HOW WE COMPARE**

- The UK Government has watered down provisions of the information and consultation directive;
- It has also watered down the working time directive including continued defence of the opt out clause;
- It has blocked the temporary agency workers directive at Council and Heads of Government level;
- It is now trying to prevent the European Constitution from enshrining many basic working rights.

### **EFFECTS OF FLEXIBLE LABOUR LAWS ON THE ECONOMY**

All the evidence suggests that watering down these provisions is also watering down our competitiveness, productivity and economic success:

- In France, where higher standards at work compared to the UK and a maximum working week are enjoyed, productivity is 25 percentage points higher than the UK and manufacturing jobs have increased by 150,000 since 1997;
- In Germany, where workplace legislation is also much tougher than the UK, productivity is 18 percentage points higher than the UK and manufacturing has increased by 120,000 jobs since 1997.

### **RECENT LABOUR MARKET STATISTICS (AS AT JUNE 2006)**

Figures published in August 2006 showed unemployment at its highest level for six and a half years. The Labour Force Survey (LFS) count was up by 92,000 to 1.68 million in the second Quarter of 2006 compared with the previous quarter. The unemployment rate under this count was 5.5%.

Employment in manufacturing in June 2006 was 3.04 million, down by over 100,000 from the previous year.

Total hours per week worked have increased by 2.6 million to 924.6million (4.4 million increase over the year).

### **PENSIONS**

State pensions in the UK are currently considerably less generous than in most OECD countries. International replacement rates (pensions expressed as percentage of earnings) demonstrate the differences in provisions.

**TABLE 10**

	<b>Pensions as a % of male earnings for:</b>		
	<b>Someone on half average earnings</b>	<b>Someone on average earnings</b>	<b>Someone on twice average earnings</b>
France	48	95	165
Germany	34	72	150
Italy	32	82	192
Netherlands	41	41	41
UK	25	34	48

*Inst of Fiscal Studies – Economic Review February 2001*

The fact that the basic state pension is linked to prices – whereas GDP tends to grow in real terms each year means that by 2050 the proportion of UK GDP spending on pensions will be less than it is today. The government is committed to link increases to earnings from 2012 following the acceptance of the Pensions Commission recommendations. However, UK spending on state pensions will still only rise to 6.7% of GDP by 2050 compared to our EU partners below.

**TABLE 11**

	<b>2000</b>	<b>2010</b>	<b>2030</b>	<b>2050</b>
France	9.8%	9.7%	13.5%	14.4%
Germany	11.5%	11.8%	16.5%	17.5%
Italy	12.6%	13.2%	20.3%	20.3%
Netherlands	4.8%	5.2%	8.3%	9.8%

*Inst of Fiscal Studies – Economic Review February 2001*

### **POVERTY IN THE UK**

A study by the Institute of Fiscal Studies, in conjunction with the Joseph Rowntree Foundation, has found that since 1997:

- While the income poverty rate has been reduced by 12%, poverty rates using spending as a measure (proportion of individuals living in households with less than 60% of the median spending, as opposed to income) have gone up 12% (to 22%);
- The child poverty rate (using spending as a measure) has risen from 25% to 27%;
- Pensioner poverty has remained roughly unchanged on spending, but on income pensioner poverty has fallen rapidly.

### **THREATS AND REFORM OF THE EUROPEAN SOCIAL MODEL**

The robust social provisions that exist in a number of European countries are currently threatened by a number of factors. Across Europe populations are ageing. The median age of Europeans is set to rise to 45 in 2020 and 50 in 2050 (106).

Social protection laws in Europe have, in the main, been created by national governments and it is these systems that have been threatened in recent times.

Denmark has adopted a form of 'flexicurity' which involves using liberal laws to hire and fire in order to adjust to the demands of international competition. This system has been credited with the fall in unemployment rates where rates have halved since 1990 from 10% to 5%. Denmark has not, however, fully embraced the Anglo-American model. The Danes have retained a generous system of unemployment benefits and a high level of spending on retraining displaced workers.

Germany has also undergone considerable reform of its social welfare system. The Hartz reforms had the following

objectives:

- Improving labour market services and policy through gains in effectiveness and efficiency.
- Activating the unemployed by enforcing the so-called principle of 'rights and duties'.
- Deregulation of the labour market.
- Erosion of employment protection legislation.

Germany has a history of providing generous unemployment benefits to preserve the social status of workers rather than providing a safety net. During the 1990s limited reforms took place including the introduction of job creation schemes and job search activities. However, sanctions for low engagement in these schemes were rare.

Alongside a more active labour market policy, a number of reforms to the system of employment protection have taken place. Reforms have focused on the temporary work sector, dismissal protection and exemptions from restrictions on fixed term contracts.

Despite the attempts at the deregulation of the labour market, Germany retains a strong collective bargaining system, and wage setting processes are relatively highly centralised.

### **PROSPECTS FOR THE EUROPEAN SOCIAL MODEL**

The evidence shows that the European Social Model has been able to maintain relatively high productivity and shorter working hours. It is also historically been able to provide superior healthcare systems compared to those in the UK and US.

In terms of manufacturing, Europe has witnessed a recent upturn in its fortunes. Since the beginning of 2006, stronger growth has been evident in the EU, in part due to the increase in exports from Germany. In July 2006 Bloomberg stated that European manufacturing had expanded the most in almost six years during June 2006, signalling a recovery for the European economy.

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(106) See Robin Blackburn: *Social Model in Europe*. *New Left Review* 34 July – August 2005

Increased sales abroad account for a rise in inward investment and a rise in the number of jobs. One economist at ABN Amro in London has stated that in 2006 “every indicator for global activity is very strong right now and that is supporting manufacturing activity” (107) .

The growth in the Euro area economy is also exceeding the expectations of the European Commission, which had predicted a 2.1% expansion during 2006.

Unemployment in countries using the euro has also decreased to 7.9% (in May 2006), the lowest figure since October 2001 (108). Unemployment has generally fallen since 1993 across Europe.

### **MOVING FORWARD**

There is little in the foregoing paragraphs to support the notion that embracing the European social model will undermine the UK economy or contribute to a decline in manufacturing. The previous chapters of this document have identified the range of factors and the global and economic events that will impact on the future of manufacturing in the UK.

As part of our strategic plans for the future of manufacturing it is important that we identify the steps necessary to bring the UK into line with EU competitors. It is equally important that we recognise the need to support campaigns on the international stage to raise living standards in those parts of the world where global corporations currently seek to exploit low labour costs. This chapter has identified current inequities and listed alongside are a number of steps around which Amicus will continue to campaign:

1. Social planning should be an integral part of companies' legal obligations utilising the corporate social responsibility ethos. Such planning should be a permanent part of the dialogue at plant, company and sector level of all industries and, amongst other things, should address retraining, redeployment and relocation issues at times of restructuring.
2. To ensure equitable treatment of all employees, government should cease to obstruct the introduction of the Temporary Agency Workers Directive.
3. Trade unions should campaign for equal rights to those enjoyed by workers in Western European industrialised countries and the freedom to take action in support of fellow workers. As part of this campaign to restore basic rights and freedoms to take industrial action, full support needs to be given to the proposed Trade Union Freedom Bill (109).
4. UK workers and their representatives would benefit from the provision of social dialogue at a national sector level. Such dialogue needs to be established with the authority to reach sector agreements on employment protection mechanisms appropriate to the industry.
5. The information and consultation regulations which came into force in 2005 and are being extended to companies with 100 – 150 employees from April 2007 must be kept under review and where necessary amendments put forward to government where they are shown not to provide employees with the equivalent protection against redundancies as provided in other European States.

(107) Dario Perkins, ABN Amro. As reported on [www.bloomberg.com](http://www.bloomberg.com)

(108) European Union Statistics Office, Luxembourg

(109) Trade Union Freedom Bill - A Bill to make provision for the law relating to the rights and freedoms of workers and of trade unions, the regulation of relations between employers and workers, protection of employment in lawful industrial action, remedies in trade disputes and for connected purposes.

# Summary and conclusions



# Summary and conclusions

This document has been designed to provide an in depth analysis of the key factors which determine the future of manufacturing and the 3 million plus workers whose lives and their families depend upon it. As with all such analyses it can only provide a snapshot of the time at which it is written and look back to learn lessons from the past. Forecasting is not an exact science and we have tried not to create a sensationalist approach or one that points in a single direction.

Manufacturing is a generic description of a wide range of very different production industries. Amicus itself divides its manufacturing membership into 13 sectors and some of those could be broken down into smaller sub sectors. To anticipate the future for industries as diverse as Aerospace, Food and Drink, Motor and Pharmaceuticals would result in several different potential scenarios. But we have identified a number of common factors which need to be addressed and which will impact in different ways on the different sub sectors of manufacturing.

Understanding the effect of economic tools and the ability of government policy to create the right environment for manufacturing to survive is crucial to the demands that we seek to place on government and the input we make to the Manufacturing Forum **(110)**. Equally important is to ensure that employers and government urgently address those issues which will create the right range of skills which manufacturing needs and the investment from both needed to achieve that.

UK manufacturing does not exist in a vacuum and an understanding of the global market now and in the future is crucial in the development of the right manufacturing strategies in the UK. Maybe it is time to challenge the popular edict that only industries with high added value and high skills can compete in the global labour market.

Perhaps we should be challenging the view that the only issue affecting location of production is labour costs. When the description and influence of foreign investment in the UK manufacturing sectors is considered, is it not time to question where the current and future control of global wealth will lead nation states and their governments? Indeed a study of the future of manufacturing raises more questions than it answers. For a union with the vision of Amicus, the contribution that we make must be heard not only at a national but an international level if we are to influence the outcome.

The role of the UK Government and the strategies that it determines are crucial to this future. Our analysis has shown what many have suspected. The current government are wedded to the concept of leaving it to the market to determine outcomes when the issues of investment, location and jobs are concerned. Whilst the market cannot be ignored neither can we afford to simply ignore the other factors which go together with market forces, which recognise social obligations, welfare and a fair distribution of the wealth created by those industries which make up manufacturing. The recommendations contained in Chapter 3 on foreign investment, of this document need to be addressed and built into our own strategies for manufacturing.

It would be inaccurate to suggest that the current government does not provide support to manufacturing. The introduction of research & development tax credits, recently extended to medium sized companies, is an essential part of their strategy, as has been the support provided by the Manufacturing Advisory Service. Ministers will point to individual companies that have benefited directly from government investment such as Airbus and direct support to MG Rover both in 2000 and belatedly in 2005. But its approach to procurement is one which

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*(110) The Forum brings together government, industry, trade unions, Regional Development Agencies, and other stakeholders to support manufacturing*

misses out on the opportunity to provide much needed support to UK workers in manufacturing. With a budget of over £125 billion spent by government departments, a policy solely committed to a value-for-money approach to public procurement, and to reduce the financial burden on the state (the taxpayer), is not necessarily in the best interests of UK manufacturing. Neither can we expect or demand a wholesale protectionist policy to exist in the UK without our competitors adopting similar strategies. Given our reliance upon exports this clearly would result in a detrimental impact upon UK manufacturing.

At the time of writing this document (August 2006), the forecasts for manufacturing business in the UK are brighter than they have been for the last two years. Reports and studies from the CBI, EEF and the Institute of Chartered Accountants (ICAEW), all record manufacturing confidence on the increase, matched by improved output figures for the first 6 months of 2006. However, these reports were based on surveys done prior to the Monetary Policy Committee decision to raise interest rates in August which, coupled with increasing prices for energy, may well dampen confidence in the autumn.

As with different results from different sub sectors of industry so confidence varies across different regions of the UK. Not surprisingly, these surveys show a distinct lack of confidence in the Midlands regions as the surveys take account of the Peugeot decision in Ryton, following on from previous, similar announcements affecting the motor industry in the West Midlands and the North West. These variations demonstrate the fragile state of the manufacturing “upturn”. The results do show a slight slow down in the pace of job losses but still a loss of 23,000 jobs is expected during the 3rd quarter of 2006 *(111)*.

Finally, we set out below our conclusions and recommendations arising from this examination of the future of manufacturing. These expand upon the stated

policies of the union and take account of changing nature of manufacturing and the global economy. However, underpinning these conclusions is a clear strategy for the union which will shape our campaigns and workplace activities in the months and years to come.



# Future of Manufacturing - Campaigning for Growth

Amicus is committed to robustly campaign to ensure the profile of manufacturing remains at the top of the political agenda and is regarded as an essential contributor to the UK economy now and into the future.

Over the last 3 years Amicus members in the manufacturing sector have developed a series of policies designed to support jobs and to defend the manufacturing industries which contribute so much to the UK economy. An examination of those policies emphasises the campaigning nature of the work that the union is expected to deliver and the need to raise the profile of manufacturing.

Existing Amicus policy has a number of broad objectives which centre on the need for government to positively support manufacturing and to provide the right economic climate for manufacturing industries to prosper. The policies encompass skills and training; investment; procurement; offshoring; regional policy and the level playing field. All of these areas have been examined in the previous pages and specific recommendations have been made throughout the document.

## **FROM THESE RECOMMENDATIONS THE FOLLOWING CONCLUSIONS CAN BE DRAWN:**

- UK manufacturing has to develop an ability to compete in a global market without the necessity to engage in reduced employment rights or low wages;
- Manufacturing will benefit from sound management of the UK economy including low interest rates and low inflation together with control of competitive energy prices;
- Recognising the benefits that can be gained from investment whether indigenous or from overseas, it follows that appropriate policies and consensus must be achieved to maximise the benefits that arise from such investment. It is equally recognised that manufacturing industry in the UK can benefit from investment overseas and that government should do more to support those UK businesses which seek to expand;
- Government procurement is a mechanism which can provide much needed support to UK manufacturing and provide sound investment for taxpayers' money. UK procurement is not just about policies but also about attitude and commitment to UK industry and jobs. Similarly many UK companies would benefit from government support in pursuing procurement opportunities elsewhere within the EU;



- The challenges of globalisation must be faced up to and the opportunities for UK manufacturing enhanced through positive government support to exporting companies. Amicus is also clear about the responsibilities which companies must exercise when expanding operations in developing nations;
- Whilst acknowledging the commitment and input to developing skills that the government has made our examination of the current situation concludes that much more needs to be done and that investment needs to be better targeted. The current strategy is, we believe, seriously flawed and it remains uncertain as to whether it will deliver the level of skills necessary for UK manufacturing to compete into the future;
- The argument for state aid is well made and the delivery of that aid in the UK needs to be better targeted and more flexible. Amicus concludes that the UK Government has much to learn from its EU neighbours in this field and that more could be achieved given the right commitment to manufacturing;
- Manufacturing cannot ignore its social responsibilities and the evidence presented in this document shows that social planning can be a force for economic good and cannot be discarded on the back of myths promulgated by the argument for flexibility.

**The conclusions above provide us with the following 10 recommendations to provide a framework for the ongoing Amicus campaign for manufacturing:**

1. An increase in government investment and incentives for research and development, to ensure greater conversion of innovation to marketable products.
2. The UK Government needs to encourage employers to recognise the corporate benefits of job security and fair terms and conditions, including pensions for its employees. Evidence shows that improved employment relations through engagement and genuine involvement create an environment conducive to improved productivity.
3. In recognition of the impact of globalisation, government needs to be urged to introduce, through Policy Instruments, guidelines which set out required standards of employment practice for inward investors to sign up to.
4. To encourage the UK government to recognise and acknowledge the role of the social model as an integral part of planning for growth in the UK manufacturing economy.
5. To emphasise the positive impact that a proactive government policy on procurement can contribute to the future of manufacturing in the UK. To encourage the government to acknowledge that the faster advancement of market liberalisation in the UK in comparison with the rest of Europe, requires a systematic process of lobbying of the EU Commission on behalf of manufacturing industry.
6. A determined approach to develop appropriate skills policies which are adequately funded and supported by both government and employers. Skills policies that address the needs of workers of all ages and levels of competence and counteract the current mismatch in what is on offer and what is required.
7. Press government to introduce and apply policies which ensure that UK manufacturing is not disadvantaged by market led policies such as energy pricing.
8. Challenge the case made for corporate offshoring and outsourcing and argue for retention of skills, experience and intellectual property in the UK.
9. Campaign for the government to support an international legally binding framework for Corporate Social Responsibility to ensure the maintenance of global labour standards in accordance with ILO and UN Global Compact guidelines.
10. To ask the UK government to acknowledge the important and unique role that manufacturing industry plays in the UK and global economy, and as such, to show the industry the support, respect and encouragement that it deserves.

## **Amicus**

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