

buy all future defence equipment from abroad would kill the aircraft industry. Thus the basic question is whether the Government should continue to act so as to keep an aircraft industry in existence.

It may be argued that the Government should not aim either to keep the British aircraft industry in business or to destroy it, but should simply act as a hard-bargaining customer in purchasing its defence needs; that it should aim always to secure the best value for money and should allow airline corporations to do the same with their own purchases. If the result of this policy is that the British industry prospers, well and good: if the result is that most British orders go overseas so that the British aircraft industry withers away, it is a pity but nevertheless the best thing for the nation in the long run.

This argument is based on the view that the forces of competition will serve to allocate the resources of the nation in the most efficient way and in the best interests of the country's economy. Any industry employs a certain amount of the nation's resources which could be employed in other ways. If some of the resources at present used by the aircraft industry could produce greater benefits elsewhere, resources should move out of the industry. It should contract to a point where further transfers no longer produce net benefits, even if this means the disappearance of the aircraft industry altogether. The mechanism of competition should be allowed to effect the transfer of resources necessary to ensure that the aircraft industry, and indeed all other industries, reach their "right" size in the economy. To facilitate this the Government should act as a competitive customer, like any other.

However, an injunction to the Government simply to act as a competitive buyer is, in the case of the aircraft industry, ambiguous and impossible to formulate as a clear-cut policy. Where relatively few big producers are making extremely complicated products to the detailed specifications of a handful of big buyers, buying and selling must necessarily involve complex judgments. There is the difficulty of making useful cost comparisons between products which often differ greatly. There will be elements of monopoly power on both sides: sellers will try to undercut rivals and drive them out of business with the aim of securing the advantages of monopoly or near-monopoly in the long run, and buyers will seek to prevent this. In situations such as these, a purchaser has to do much more than merely apply simple market-place tests to particular transactions.

Furthermore, governments are the main customers of aircraft industries and exercise a big influence in many other ways over the activities of their industries throughout the world. As a result many kinds of support, some large, some small, some identifiable, some hidden or indirect, are enjoyed by the British industry's competitors overseas. Most countries, including Britain, have tariffs, subsidies, and many other institutional or conventional barriers to the free working of the competitive mechanism.

Another consideration applies to the British aircraft industry. Britain's successful aero-engine and equipment industry is in a large measure tied to the fortunes of the airframe industry. If a completely *laissez-faire* policy were adopted on airframes, the prosperity of the rest of the industry would, we believe, suffer in consequence.

For the foregoing reasons, even on the assumption that the forces of competition, broadly interpreted, will bring about the best allocation of the nation's resources, we reject the simple view that the Government should always buy aircraft in the cheapest market. There is another more fundamental objection to such a policy. Where an industry provides substantial indirect benefits to the nation, it may be worthwhile for the Government to provide it with some support.

It can be claimed that Britain enjoys a number of indirect benefits from the existence of the British aircraft industry. We have to establish what these are and, having done so, ask two further questions:—

- (a) How much special support is it worth the Government giving the industry to retain these benefits?
- (b) Can a British aircraft industry survive and flourish with no more than this level of support?

In this section of the report we set out to answer the first of these questions.

The main reasons for giving the aircraft industry special

support or preferential treatment can be considered under the following headings:

- (1) Defence and foreign policy.
- (2) Social contribution.
- (3) External benefits or side-effects in terms of technology.
- (4) Contribution to the balance of payments.
- (5) Difficulty of attaining a stable level unaided.

These are discussed in turn in Chapters 12-16. In Chapter 17 we try to assess the amount of support or special treatment the industry is currently receiving. In Chapter 18 we try to balance the reasons in favour of special treatment against the special treatment actually received, with a view to making a broad judgment as to how much support is justified in future.

CHAPTER 12

Defence and Foreign Policy

Traditionally, the strongest argument for maintaining an aircraft industry in this country has been that it was essential for defence. Until some years after the Second World War the case was put primarily in terms of war potential. If war came, aircraft production would need to be expanded without having to build up an industry from scratch. But in the thermo-nuclear age this argument has been much weakened. The outcome of a major war will depend on the weapons available to each side when it starts. Even a limited war is unlikely to involve a major and speedy build-up of defence production like that in the Second World War.

Today the main defence argument for having a domestic industry capable of supplying major weapon systems is that it provides a measure of independence in British foreign policy, especially in circumstances where we might have to consider using force. Without an industry of our own, our policy would be in the hands of the supplying country which could always cut-off supplies, including spares. This argument must of course be qualified. The main alternative supplier would be the United States, and other possible suppliers our NATO allies. Our foreign policy already takes into account the views of our allies and certainly any contemplated use of force takes considerable account of the views and policies of the United States.

There are several subsidiary defence arguments in favour of a domestic industry. First, if we were to buy all our military aircraft abroad and our domestic industry withered away, we would risk being forced to pay more for an aircraft from a monopoly supplier than if we still had the capacity to build it ourselves.

Second, if we bought abroad, the Services might not get aircraft so nearly meeting their detailed requirements. The numbers Britain needs are small, and it would not usually pay the United States to modify their own requirements greatly to meet ours. We might also find it difficult or costly to get spares. On the other hand, as the Services have already found, high costs are increasingly limiting the number of specialised requirements they can pursue. The large United States defence programme affords a wide choice of proven weapon systems.

Third, substantial buying abroad would expose the defence programme to cuts in the event of a drastic balance of payments crisis. Furthermore, opting for a foreign weapon entails the risk that it might be cancelled during development, as was Skybolt.

These arguments must be weighed against the higher cost of buying at home. It might seem premature to consider this here, since we have not yet assessed all the grounds for paying Government support in this way. But in establishing how much military independence it is sound to seek, we cannot ignore cost. More independence might be worth paying more for, but there is an upper limit set by the total resources which the nation is prepared to allocate to defence. Judgment has to be made on the degree of defence benefits which should be sought. Ultimately this judgment can best be made by those responsible at the same time for defence policy and for making the defence budget go as far as possible.

The broad picture is plain enough. The United States has, and seems bound to have in future, an inherent cost advantage over Britain in aircraft manufacture. This advantage is so pronounced on the largest and most complex military aircraft that, whatever expedients are adopted, the British industry