International Debate on Re-Industrialization

A Panacea for Economic Recovery?

by Philine Schuseil and Christopher Sandmann
with the assistance of Demelza Hays

According to James Boxell of the Financial Times, the past decade has been miserable for France's industry. A good example is the auto industry where the number of jobs declined by more than half between 1980 and 2010. Yet the development in other European economies such as Germany proves that carmakers can employ more people today than they did three decades ago.

These days, the issue of désindustrialisation figures heavily on the French political agenda. One of President François Hollande's campaign promises in 2012 has been to help the French industry get back on its feet. In late 2013, French Industry Minister (Ministère du redressement productif) Arnaud Montebourg presented 34 measures in order to redress ("re-industrialize") the French economy. Montebourg presents himself as a fervent fighter for the French industry: "We will fight to the death for our industrial base". The General Public got a taste for this fight when Montebourg decided on the acquisition terms of one of the nation's showpiece companies and manufacturer of the TGV, Alstom. The French government now holds a 20 % stake in the company and monitors the new owner General Electric carefully to abide to its promise of new job creation. According to Guido Hülsmann, our second contributor, libertarian and staunch believer in market self-regulation, government interventionism is partly to blame for the decline in industrial production in the developed economies.

Can re-industrialization really help the French economy get back on its feet?

Francesco Daveri, our first contributor, from Parma University believes that re-industrialization can play an essential role in the economic recovery of Europe. He cites the convergence rates of manufacturing in Eastern Europe after the crisis as compelling evidence. "GDPgrowth has often recovered faster where manufacturing production has regained weight at a faster speed." However this entails reverting a long run trend that has been prevalent in developed economies regardless of the dominant economic policy. Indeed one pattern in the structure of developed economies since the late 1960s is the decline of the manufacturing sector employment in manufacturing as a share of total employment has fallen dramatically. Economic historians generally identify a number of factors which may explain the long-run deindustrialization trend of mature economies, especially in the U.S. and Europe.

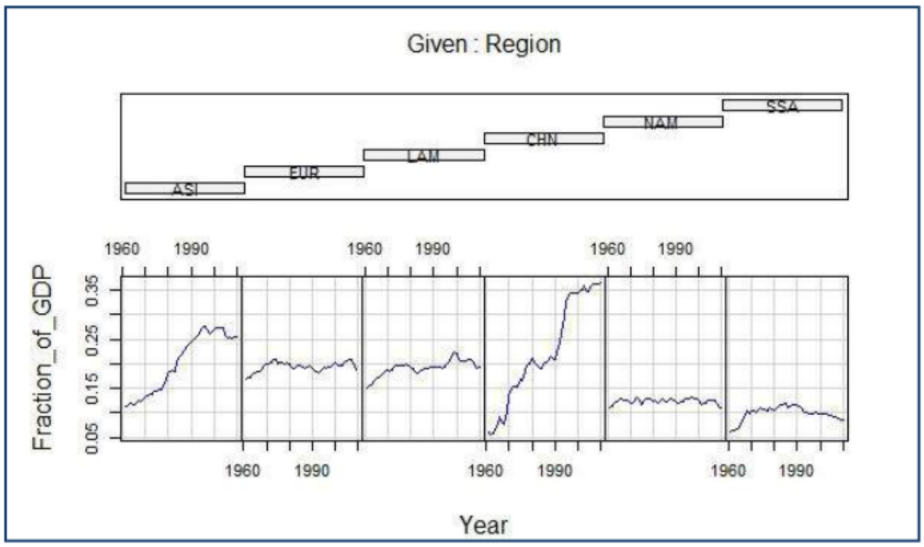
Productivity (i.e. output per worker) has been shown to rise faster in manufacturing than in services. As a consequence, employment shifts to the service sector because fewer workers (relative to the service sector) are needed to produce the manufactured goods the economy requires in the future.

As **real incomes increase,** individuals tend to prefer to spend more of any extra income on services rather than on manufactured goods. This strengthens the effect of different productivity rates across sectors. **Labour mobility between countries** of divergent socio-economic development is constrained relative to the mobility of capital. Therefore, manufacturing firms can outsource labour to developing countries, not just because wages are lower, but because wage-productivity ratios are in some cases much lower.

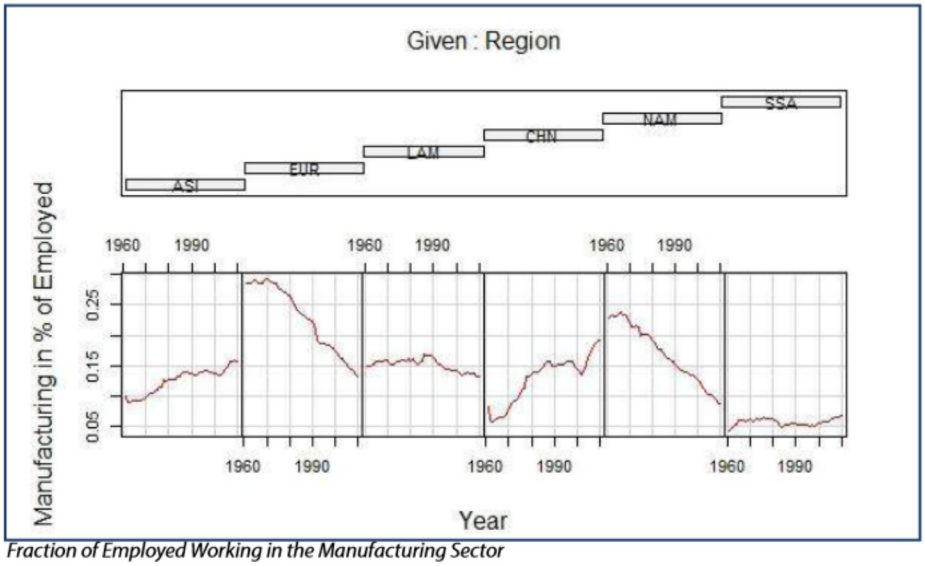
The de-industrialization phenomenon has given rise to a debate about its causes and likely implications. Many regard it with alarm and suspect saying that it has contributed to high unemployment in Europe. Some suggest that it is a result of the globalization of markets and has been fostered by the rapid growth of North-South trade. They also argue that the fast growth of labour-intensive manufacturing industries in the developing world is displacing the jobs of workers in the advanced economies.

However, an IMF working paper by Rowthorn and Ramaswamy (1997)[1] concludes that deindustrialization is **not a negative phenomenon, but rather a natural consequence of further growth in advanced economies.** Trade among industrial countries (rather than between industrial and developing countries) accounts for some of the differences in employment structure between different advanced economies - the phenomenon is not due to increasing North-South trade. Moreover, future growth within the developed world is likely to depend increasingly on productivity growth in services.

[1] IMF Working Paper 1997."Deindustrialization: Causes and Implications", by Robert Rowthorn and Ramana Ramaswamy.



Manufacturing Output in Percent of GDP



Fraction of Employed Working in the Manufacturing Sector

Graph Description

The data is taken from the University of Groningen GGDC 10-Sector Database.[2] The red graph shows the number of people employed in manufacturing as a percentage of the overall employed population. The blue graph indicates the output share manufacturing in percent of total GDP. Time series are plotted for China (CHN) and cross country aggregates for Asia (ASI), Europe (EUR), Latin America (LAM), the US (NAM) and Sub-Saharan Africa (SSA).

Is this debate limited to advanced economies or is deindustrialization a more global phenomenon?

Meanwhile Andi Rodrik, our third guest author, from Princeton University has observed a troubling trend. Deindustrialization is not exclusive to advanced economies but prevalent in all regions but Asia. Developing nations are becoming service economies without having had a proper experience of industrialization. He has coined this process "Premature de-industrialization". In a new paper he argues that the conventional explanation of de-industrialization is incomplete. De-industrialization is not only driven by technological progress but also determined by globalization. As prices are determined globally developing countries are exposed to the world market. In other words, they must compete with low prices that didn't exist when today's advanced economies industrialized. ■

Reindustrialization - a panacea for Europe?

by Francesco Daveri *(Università di Parma)*

After two decades of outsourcing and offshoring, things may be changing in the Western world: insourcing and onshoring have now become the buzzwords of the day. In the United States, generous State aid and the discovery and exploitation of extensive shale gas reserves have revived the American industry after the crisis of 2008-09. Manufacturing production in the US economy has gone up by 20 percentage points compared to its low of June 2009. The rapid increase of manufacturing was twice faster than the (remarkable) growth of US GDP over the same period of time.

Reindustrialization is not an exclusive feature of the American economy. The variety of growth experiences in Europe shows that GDPgrowth has often recovered faster where manufacturing production has regained weight at a faster speed. Germany, with its 10 per cent GDP gain paralleled by a 25 per cent recovery in manufacturing production since early 2009, is an obvious case in point. Yet more impressive numbers apply to many countries in Eastern Europe. In Poland, Slovakia, the Czech Republic, Hungary and the three Baltic States, GDP has undergone fast recovery driven by rapid growth in the manufacturing sector, from a minimum of 24 per cent (Hungary) to a maximum of 59 per cent (Estonia) since their 2009 lows. For Eastern Europe this continues the former process of rapid manufacturing development, prematurely discontinued by the Great Recession. Part of this growth may be driven by the offshoring of some German manufacturing activities in search of low-wage engineering and technical skills. But these numbers also indicate that Eastern Europe's manufacturing can compete with its Turkish and Chinese competitors. In the rest of Europe, the UK and France has shown GDP and manufacturing growth at similar, intermediate, speeds, while both industry and overall Gdp growth is still largely missing in Southern Europe.

The variety of growth trends across Europe invites the question of whether the post-Lehman return of industry in some countries represents a chance to end the current crisis even in those countries where growth has returned yet. If yes, then reindustrialization may be a panacea for Europe's problems. The answer is a qualified yes. All European countries are global economies whose consumers need imports to carry out their preferred consumption plans. And imports require exports (plus net income from abroad) to be sustained. And, in turn, exports still largely mean maintained industrial competitiveness.

[2] The data can be found under the following address http://www.rug.nl/research/ggdc/data/10-sector-database

The return of industry is thus, to some extent, a necessity rather than a choice. Many object that, if every European country specializes and exports similar manufacturing products, this would result in excess supply and eventually in a self-defeating loss of terms of trade. Yet this argument overlooks that the trade of European countries is largely of an intra-industry nature. The foreign trade of France and Germany does not merely involve the exchange of Champaigne for refrigerators, but also the within-industry reciprocal exchange of cars (of somewhat different qualities). If this component of trade remains majoritarian, reindustrialization may still be a panacea for Europe, after all. ■

by Jörg Guido Hülsmann *(Université Angers, Senior Fellow Mises Institute)*

Is deindustrialization a "natural phenomenon" of developed economies? Have "re-industrialization" measures nevertheless the potential to contribute to the recovery of European economies such as France?"

Let me first state my position and then add a few arguments to back it up. Economic growth typically entails a re-allocation of labour away from industrial production, but it does not all by itself lead to falling industrial output. The decline of industrial production in the US and France in the past thirty years is to some extent due to capital exports, but especially to government interventionism in the form of mushrooming labour, business and financial regulations, education policies, social security funding, and taxation. This decline cannot be stopped through more interventions, even if they are designed with the good intention to reindustrialise the country.

Now let me offer a few considerations in support of these contentions.

The reallocation of labour in a growing economy results most notably from capital accumulation and from changing preferences of the working-age population. Further investments and extensions of the existing structure of production make it necessary to spend more time devising new methods, preparing industrial activity, coordinating and monitoring supply chains. Low-quality blue-collar labour diminishes, whereas there is some increase in high-quality blue-collars, but especially an increase in white-collars working in and around the supply chains.

Increasing real revenues affect people's lifestyle choices. Rather than labouring long hours that provide essentially a monetary reward, they increasingly prefer enjoyable activities that provide immediate psychological and emotional rewards. Thus the blossoming of artistic, intellectual, and scientific activities in developed countries, at the expense of traditional industrial pursuits.

As a natural consequence of economic growth, therefore, industrial production declines relative to what it could be if it attracted even more people. But this does neither imply a shrinking physical industrial output, nor does it imply shrinking industrial revenues. Capital accumulation and technological progress make it possible that industry thrives even when less people have industrial employment. Germany provides an example.

In the past thirty years, western capitalists have invested large amounts of capital in formerly communist countries of the East and Far East. This reallocation of capital, though beneficial from the overall point of view of the world economy, has been detrimental in the short-run to the industrial development of those western countries where the capital would otherwise have been used.

But capital investments in countries such as France and the US have declined even more as a result of mushrooming government interventions. Welfare cheques diminish the incentive to accept low-paying and non-gratifying industrial jobs. Massive subsidies for secondary and higher education artificially prolong schooling; reduce the supply of qualified manual labour; and create an artificial bias among the working-age population for scientific, intellectual, and artistic activities. Panoply of regulations have, on the one hand, increased the costs of doing business and, on the other hand, stimulated rent-seeking and manifold forms of evasion and regulatory arbitrage. Today they are feeding entire armies of lawyers, accountants, auditors, and financial advisors, all at the expense of ordinary business.

[3] This is a reprint taken from Andi Rodrik's webblog http://rodrik.typepad.com/. The paper discussed is "Premature Deindustrialization," NBER Working Paper No. 20935, February 2015.

These tendencies cannot be stopped through so-called reindustrialisation policies, which boil down to even more government spending, premised on the spurious notion that irresponsible (and often also inexperienced) politicians know best how to use the available scarce resources. Such policies have utterly failed in the past (Airbus included), and will fail in the future. Genuine reindustrialisation requires more oxygen for industry. It requires nothing less than a rollback of the artificial obstacles for industrial development that government interventions have created in past generations. ■

Premature deindustrialization in the developing world[3]

by Dani Rodrik *(Princeton University)*

Mention "deindustrialization," and the image that comes to mind is that of advanced economies making their way into the post-industrial phase of development. In a new paper, I show that the more dramatic trend is one of deindustrialization in the developing countries. This is a trend that is appropriately called premature deindustrialization, since it means that many (if not most) developing nations are becoming service economies without having had a proper experience of industrialization.

Latin America appears to be the worst hit region. But worryingly similar trends are very much in evidence in Sub-Saharan Africa too, where few countries had much industrialization to begin with. The only countries that seem to have escaped the curse of premature industrialization are a relatively small group of Asian countries and manufactures exporters. The advanced countries themselves have experienced significant employment de-industrialization. But manufactures output at constant prices has held its own comparatively well in the advanced world, something that is typically overlooked since so much of the discussion on deindustrialization focuses on nominal rather than real values.

The conventional explanation for employment deindustrialization is based on differential rates of technological progress. Typically, manufacturing experiences more rapid productivity growth than the rest of the economy. This results in a reduction in the share of the economy's labor employed by manufacturing when the elasticity of substitution between manufacturing and other sectors is less than unity. This explanation cannot account for the decline in the output share of manufacturing at constant prices, however, as differential technical progress in manufacturing would increase the MVA share. Moreover, developing countries tend to be small in world markets for manufactures, where they are essentially price takers. The above mechanism, which operates through relative price changes, does not work for small open economies. In the limit, when relative prices are fixed, more rapid productivity growth in domestic manufacturing actually produces industrialization, not deindustrialization (in terms of both employment and output). So the culprit for deindustrialization in developing countries must be found elsewhere.

The obvious alternative is trade and globalization. A plausible story would be the following. As developing countries opened up to trade, their manufacturing sectors were hit by a double whammy. Those without a strong comparative advantage in manufacturing became net importers of manufacturing, reversing a long process of import-substitution. In addition, developing countries "imported" deindustrialization from the advanced countries, because they became exposed to the relative price trends produced in the advanced economies. The decline in the relative price of manufacturing in the advanced countries put a squeeze on manufacturing everywhere, including the countries that may not have experienced much technological progress. This account is consistent with the strong reduction in both employment and output shares in developing countries (especially those that do not specialize in manufactures).

In sum, while technological progress is no doubt a large part of the story behind employment deindustrialization in the advanced countries, in the developing countries trade and globalization likely played a comparatively bigger role.

Deindustrialization has been long been a concern in rich nations, where it is associated with the loss of good jobs, rising inequality, and decline in innovation capacity. For all these and many other reasons, it should be a much bigger problem for developing countries. Premature deindustrialization has serious consequences, both economic and political.

On the economic front, it reduces the economic growth potential and the possibilities for convergence with income levels of the advanced economies. Formal manufacturing tends to be technologically the most dynamic sector, exhibiting unconditional convergence. Deindustrialization removes the main channel through which rapid growth has taken place in the past.

The political consequences of premature deindustrialization are more subtle, but could be even more significant. Mass political parties have traditionally been a by-product of industrialization. Politics looks very different when urban production is organized largely around informality, a diffuse set of small enterprises and petty services. Common interests among the non-elite are harder to define, political organization faces greater obstacles, and personalistic or ethnic identities dominate over class solidarity. Elites do not face political actors that can claim to represent the non-elites and make binding commitments on their behalf. Moreover, elites may prefer – and have the ability – to divide and rule, pursuing populism and patronage politics, and playing one set of non-elites against another. Without the discipline and coordination that an organized labor force provides, the bargains between the elite and non-elite needed for democratic transitions and consolidation are less likely to take place. So premature deindustrialization may make democratization less likely and more fragile. ■