The Economics of Why Manufacturing Matters

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The Economics of Why Manufacturing Matters

• Recent focus on manufacturing as a source of future growth and to help the ‘rebalancing’ of the economy

• But does manufacturing matter?

• If it does, what are the ways forward?
Manufacturing as share of the UK economy (GVA)

Note: ‘Other Production Industries’ includes: mining & quarrying; agriculture, forestry & fishing; energy and utilities; and construction.

Source: UK Office for National Statistics

Cited in PWC (2009)
George Osborne has declared that he wants to start a "march of the makers".
Does Manufacturing Matter?
NO
Why Manufacturing “Does Not Matter”
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1. ‘Deindustrialisation’ is a common feature of modern advanced economies
2. ‘Comparative advantage’ indicates that advanced economies should focus on services
3. Productivity differentials result in a declining share of employment in manufacturing
4. Consumers demand more services as they get richer
5. Structural change and the reclassification of activities
Is ‘Deindustrialisation’ is a common feature of modern advanced economies?

- Yes
- But the rate of decline has been much greater in the UK than in most other advanced countries.
‘Comparative advantage’ indicates that advanced economies should focus on services

• Comparative advantage is not a static concept

• Countries may get locked into an inappropriate economic structure resulting in low overall economic growth

• Comparative advantage can be changed by public policies and structural change
Productivity differentials result in a declining share of employment in manufacturing

• But this does not explain the slow growth of output

• If productivity is higher in manufacturing then an overall shift to manufacturing will increase overall economic growth
Relative Productivity of UK Manufacturing 1991-2009

Source: ONS  Cited in BIS (2010)

Cited in PWC (2009)

Source: UK Office for National Statistics
Consumers demand more services as they get richer

- The evidence is mixed
- Expenditure on manufactures has declined in monetary terms
- But expenditure on manufactures has not declined in real terms
Deindustrialisation is caused by structural change and the reclassification of activities

- Contracting out of activities from manufacturing to specialist service providers (e.g., design, catering, and transport)
- But can only explain a modest fall in manufacturing output and employment
- And many manufacturing firms now provide services as well as physical products
Does Manufacturing Matter?
YES
Why Manufacturing Does Matter
Why Manufacturing Does Matter

- Manufacturing is an engine of growth
- Manufacturing is an important source of exports
- Manufacturing as an integral component of national economic and innovation system
  - Source of positive spill-overs
  - Development of technologies for sustainable growth
Manufacturing is an engine of growth

- Manufacturing productivity (output per worker) is relatively high
- Manufacturing benefits from economies of scale
- A larger manufacturing sector can deliver higher overall economic growth
Relative Productivity of UK Manufacturing 1991-2009

Source: ONS  Cited in BIS (2010)
Manufacturing is an important source of exports

• Manufacturing is an important source of exports

• But UK balance of trade has been consistently negative over the past 25 years

• This has deficit has been funded by borrowing and the sale of assets

• Such trade deficits are unlikely to be sustainable in the future

• Need to reverse the manufacturing trade balance
Exports as a Share of Manufacturing production (selected countries)
UK Manufacturing Balance of Trade, 1970-2007

Britain's overall balance of trade has been consistently negative for the past 25 years, worsening significantly in the past decade.

Source: UK Office for National Statistics

Cited in PWC (2009)
Manufacturing as an integral component of national economic and innovation system

• Innovation is required for sustained economic growth

• Manufacturing is a source of innovation and positive spill-overs ('externalities') which improve growth in other sectors

• Manufacturing is a sources of technologies for sustainable growth
Manufacturing in the UK

• The relative decline of manufacturing in the UK has been greater than other advanced countries

• The UK is suffering from ‘negative deindustrialisation’

• This has been masked balance of payments deficits during the past 25 years – which are now unsustainable

• The manufacturing base is dangerously small to contribute to significant overall growth in the future
Reversing ‘Negative Deindustrialisation’

• The policy approach to manufacturing has been one of ‘benign neglect’

• No coherent industrial policy
  • The fear of ‘picking winners’

• Lack of long-term investment
  • Lack of finance

• Lack of stable markets
  • Although there are some exceptions (eg pharmaceuticals and aerospace)

• Exacerbated by periods of exchange rate instability
Investment in Fixed Capital, 1991-2011 (% of GDP)

Source: NESTA and Oxford Economics
Government Budget Outlays on Research and Development (weighted by size of country), 2007=100

Source: OECD and NESTA
Moving forward

• Governments must invest in technology and new ideas to ensure future growth

• If the financial sector is reluctant to finance investment, the government must fill the gap

• Need for a coherent industrial policy which targets strategic sectors
References

Publications
BIS (2010) Manufacturing in the UK: Supplementary Analysis
NESTA (2012), Plan I: The Case for Innovation Led Growth
PWC (2009), The future of UK manufacturing: Reports of its death are greatly exaggerated, PWC, London

Data
ONS

See also