

Does Manufacturing Matter?

by Ramana Ramaswamy and Robert Rowthorn



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opinion

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The short answer is: not much.
And that's a good thing.

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EMERGING MARKETS remain rocky, Japan is still struggling with its worst crisis since World War II, and economic activity has been anemic across much of the European Union, but growth in the United States powers ahead at a robust 4% per year. The current business cycle expansion, which started in 1991, has already become the stuff of legend. But even as recently as five years ago, policy debates in the United States were laced with pessimism about the sustainability of American economic leadership. Policy wonks called for the United States to emulate Japan, develop an industrial policy, save manufacturing, and restore American might.

The longest unbroken expansion in history appears to have diminished perceptions of dwindling U.S. economic power. But residual pockets of insecurity remain; unease about lost manufacturing jobs echoed last winter in the streets of Seattle. Indeed, manufacturing's share of total employment in the United States has fallen dramatically—from about 28% in 1970 to about 14% today. How can our economy be so strong if our manufacturing sector is so weak?

The paradoxical answer is that the decline in the share of manufacturing jobs—the deindustrialization of the U.S. economy—is actually a sign of strength, not weakness. It's not due, as many are contending, to a flood of cheap imports from low-wage countries, nor, as some in the economics community have

argued, to a shift in consumer preferences toward services. On the contrary, as with the agriculture sector 100 years before, the drop in employment in the manufacturing sector stems from spectacular productivity growth. Over the last three decades, modern production techniques have churned out manufactured goods with ever-increasing efficiency. The U.S. economy no longer needs hoards of factory workers for the same reason it no longer needs legions

of farmers— it can produce what it requires with far fewer people. The roots of our current robust economy are internal. Good macroeconomic management, the stock market boom, and a business climate favoring innovation have played major roles. But having

ity most exposed to international trade (manufacturing) has become a smaller part of the economic pie over time. That helps explain why many U.S. workers hardly seemed to feel the tremors of the currency collapses in emerging markets in the late 1990s.



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Contrary to headlines, deindustrialization has actually reduced the vulnerability of the U.S. economy to economic crises elsewhere. Despite growing trade links among countries over the last 20 years, the amount of imports and exports in the total economic activity of the United States has remained much the same. So the activ-

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an ever more efficient manufacturing sector matters less and less for maintaining the dynamism of the U.S. economy. The real driver of growth is the service sector, where employment grew rapidly in the last couple of decades. And in the past four years, productivity in the service sector has doubled.

The Internet has made it possible for the service sector to enjoy efficiency gains – through standardization, for instance – that were once the exclusive preserve of manufacturing. And the Net has introduced economies of scale to the service sector through an expansion of business-to-business transactions and access to a growing potential customer base. As service providers more fully exploit the potential of new technologies, they will continue to drive overall productivity increases in the economy and enhance standards of living in the future.

But if the U.S. economy was not in as much trouble as critics thought half a decade ago, neither is it totally secure in a new era of growth without end. Economic growth is, by definition, the sum of the growth rates in productivity and employment, and a tightening labor market will likely put a brake on employment growth. What's more, errors in formulating government policies, fluctuations in stock and property prices as expectations rise and ebb, and temporary imbalances between supply and demand in various sectors are all bound to occur – and will keep the business cycle alive.

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