

The Perils of Premature Deindustrialization

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Most of today's advanced economies became what they are by traveling the well-worn path of industrialization. A progression of manufacturing industries – textiles, steel, automobiles – emerged from the ashes of the traditional craft and guild systems, transforming agrarian societies into urban ones. Peasants became factory workers, a process that underpinned not only an unprecedented rise in economic productivity, but also a wholesale revolution in social and political organization. The labor movement led to mass politics, and ultimately to political democracy.

Over time, manufacturing ceded its place to services. In Britain, the birthplace of the Industrial Revolution, manufacturing's share of employment peaked at around 45% before World War I and then fell to just above 30%, where it hovered until the early 1970's, when it began a precipitous decline. Manufacturing now accounts for slightly less than 10% of the workforce.

All other rich economies have gone through a similar cycle of industrialization followed by deindustrialization. In the United States, manufacturing employed less than 3% of the labor force in the early nineteenth century. After reaching 25-27% in the middle third of the twentieth century, deindustrialization set in, with manufacturing absorbing less than 10% of the labor force in recent years.

In Sweden, employment in manufacturing peaked at 33% in the mid-1960's, before falling to the low teens. Even in Germany, often regarded as the strongest manufacturing economy in the developed world, manufacturing employment peaked around 1970, at close to 40%, and has been steadily declining ever since. As Harvard University's Robert Lawrence [has argued](#), deindustrialization is common and predates the recent wave of economic globalization.

Only a few developing countries, typically in East Asia, have been able to emulate this pattern. Thanks to export markets, South Korea industrialized exceptionally rapidly. With manufacturing's share of employment rising from the low single digits in the 1950's to a high of 28% in 1989 (it has since fallen by ten percentage points), South Korea underwent in three decades a transformation that took a century or longer in the early industrializers.

But the developing world's pattern of industrialization has been different. Not only has the process been slow, but deindustrialization has begun to set in much sooner.

Consider Brazil and India, two emerging economies that have done comparatively well in the last decade or so. In Brazil, manufacturing's share of employment barely budged from 1950 to 1980, rising from 12% to 15%. Since the late 1980's, Brazil has begun to deindustrialize, a process which recent growth has done little to stop or reverse. India presents an even more striking case: Manufacturing employment there peaked at a meager 13% in 2002, and has since trended down.

It is not clear why developing countries are deindustrializing so early in their growth trajectories. One obvious culprit may be globalization and economic openness, which have made it difficult for countries like Brazil and India to compete with East Asia's manufacturing superstars. But global competition cannot be the main story. Indeed, what is striking is that even East Asian countries are subject to early-onset deindustrialization.

Consider China. In view of its status as the world's manufacturing powerhouse, it is surprising to discover that manufacturing's share of employment is not only low, but seems to have been declining for some time. While Chinese statistics are problematic, it appears that manufacturing employment peaked at around 15% in the mid-1990's, generally remaining below that level since.

China is a very large country, of course, with much of its workforce still in rural areas. But most migrant workers now find jobs in services rather than in factories. Similarly, it is extremely unlikely that the new crop of manufacturing exporters, such as Vietnam and Cambodia, will ever reach the levels of industrialization attained by the early industrializers, such as Britain and Germany.

An immediate consequence is that developing countries are turning into service economies at substantially lower levels of income. When the US, Britain, Germany, and Sweden began to deindustrialize, their *per capita* incomes had reached \$9,000-11,000 (at 1990 prices). In developing countries, by contrast, manufacturing has begun to shrink while *per capita* incomes have been a fraction of that level: Brazil's deindustrialization began at \$5,000, China's at \$3,000, and India's at \$2,000.

The economic, social, and political consequences of premature deindustrialization have yet to be analyzed in full. On the economic front, it is clear that early deindustrialization impedes growth and delays convergence with the advanced economies. Manufacturing industries are what [I have called](#) "escalator industries": labor productivity in manufacturing has a tendency to converge to the frontier, even in economies where policies, institutions, and geography conspire to retard progress in other sectors of the economy.

That is why rapid growth historically has always been associated with industrialization (except for a handful of small countries with large natural-resource endowments). Less room for industrialization will almost certainly mean fewer growth miracles in the future.

The social and political consequences are less fathomable, but could be equally momentous. Some of the building blocks of durable democracy have been byproducts of sustained industrialization: an organized labor movement, disciplined political parties, and political competition organized around a right-left axis.

The habits of compromise and moderation have grown out of a history of workplace struggles between labor and capital – struggles that played out largely on the manufacturing shop floor. Given premature deindustrialization, today's developing countries will have to travel different, as yet unknown, and possibly bumpier paths to democracy and good governance.