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Combining Manufacturing Employment with Economic Development in the Global Era

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Under what conditions can manufacturing employment drive economic growth? Development scholars and commentators have taken note of the significance of economic globalization, characterized by increased "off-shoring" of manufacturing activities from advanced countries to developing nations. Aided by the dismantling of trade/investment barriers and the decline in transportation and technology costs, the production process has increasingly been divided into smaller segments of activities that are carried out in diverse geographical locations. Some have pointed to the recent growth experiences of East Asian countries to argue that this period presents novel opportunities for developing nations to structurally transform their economies. Specifically, the relocation of more labor-intensive activities to developing nations with lower labor costs allows these countries to industrialize and move significant portions of their workforces into higher productivity activities. Policies aimed at attracting foreign investment and encouraging manufacturing export performance have involved entering trade agreements that reduce barriers to trade, capital account liberalization, tax incentives, and deregulation aimed at increasing labor market "flexibility."

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In contrast, others question the idea that participation in globally integrated production networks will automatically yield positive developmental returns. As the global manufacturing sector is geographically restructured, the more competitive aspects of the production process tend to be offshored. The firms that enter particular segments of manufacturing activities face heightened competition as more economic actors take on these activities. Furthermore, the asymmetry in bargaining power that results from many firms in developing nations supplying a significantly smaller number of lead firms in the advanced countries means that firms in advanced countries are better able to dictate terms of exchange with firms from developing nations (Kaplinsky 2005; Mahutga 2012). In sum, the declining barriers to entry and increasing competition induce a decline in returns to manufacturing activities.

In my work, I test these competing views on the importance of formal manufacturing employment for economic growth using panel methods and data from a broad sample of developed and less developed countries (LDCs) over the period 1970-2010 (Pandian 2017). While I find that manufacturing share of employment has a strong positive impact on economic growth for all countries during the time period studied, I find that this positive effect has tended to decline considerably in magnitude for LDCs, particularly after 1990. In contrast, my results do not show a decline in this effect for advanced economies. In sum, my work provides empirical support for the second view on globalization and its impact on the developmental returns to manufacturing employment for LDCs. These findings are consistent with other findings in the literature that document the weak bargaining position of firms in the global South vis-à-vis firms in the global North. Other research has implicated the competitive pressures associated with globalization in the process of "premature deindustrialization" in developing nations (e.g. Rodrik 2016).

To be sure, from the perspective of developing nations, it is certainly desirable to structurally transform the economy by moving large sections of the workforce from low to higher productivity activities. Indeed, the manufacturing sector seems uniquely capable of being part of such a transformation, with its ability to quickly absorb shifts in labor away from the agrarian sector. However, efforts directed toward such a transformation must not be undertaken with the assumption that trade and capital account liberalization, tax incentives for businesses, and labor market deregulation will automatically lead to developmental dividends. Instead, a deliberate policy framework with active industrial and trade policy seems essential. First, in addition to ensuring macroeconomic stability and investing in fundamentals (education, infrastructure etc.), industrial policy must be geared toward guiding or subsidizing investment in strategic sectors and providing resources to build up capabilities of domestic firms in segments of supply chains that can generate more value. As the extensive literature on developmental states documents, these are not novel policies. Industrial policies that have interfered with the operation of markets have been vitally important for the development of late industrializers (e.g. Amsden 1989). On the other side, to discourage rent-seeking behavior, this form of state intervention must also be accompanied by a framework for ensuring that the beneficiaries of industrial policy comply with performance and quality standards to be competitive in export markets. Historically, successful developmental states have had in place such state institutions (e.g. South Korea) to minimize inefficiencies related in industrial policy (Amsden 1989).

Second, trade policy must entail selective or strategic integration with the world economy. The experiences of China and other East Asian economies have shown that integration can be important. However, this does not mean that policies designed simply to expand international trade for its own sake will necessarily lead to positive developmental outcomes. Indeed, these same East Asian economies engaged in protecting certain industries from foreign competition and controlled the pace of subsequent integration. Further, cultivating trading relationships with other regional developing economies might allow late developers to make use of beneficial spillovers and more efficient logistics (Kaplinsky 2005). For example, a striking feature of successful East Asian economies is their level of interconnectedness which reflects the extensive regional value chains that span these economies. Trade with other developing nations could also enhance the ability of domestic firms to engage in product/process upgrading due to their improved bargaining position vis-à-vis lead firms in developed countries.

Third, instead of pursuing labor market deregulation, states should do more to ensure a more equitable income distribution. Empowering labor not only keeps income inequality in check, it also supports a wage-growth led development strategy, especially in large countries, where an upwardly mobile workforce could serve as a sustainable source of demand in the domestic market. Further, as Hung (2015) documents, rapid economic development is not incompatible with wage growth. Unlike the Chinese experience, a number of East Asian economies (e.g. South Korea, Taiwan) combined rapid industrialization with increases in industrial wages through state investment in rural development schemes.

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