How to refute conventional economic wisdom

Yes we can. Why not?

We could relocalise and protect industries, pay workers more and use state aid. All this is possible if we ignore everything we've been told for 40 years.

by Laura Raim

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'Industry is finished, services are in.'

Why fight the tide of history? Industry is simply going the same way as agriculture. Development means shifting from the primary sector to the secondary, and then the tertiary, so the countries of the North are moving to an intangible, service-based economy powered by 'businesses without factories' (as the then CEO of Alcatel, Serge Tchuruk, put it in 2001), while manufacturing, which is dirty and difficult, is delocalised to low-wage economies.

But industry and services aren't opposites: they are overlapping, complementary sectors. The outsourcing of former in-house functions such as catering, cleaning and even accounts over the past 20 years partially explains why the number of people directly employed in industry has fallen while the number in services has grown. At the same time, industrial companies are offering more services, such as installation, maintenance and hire. In France, you can hire tyres from Michelin and pay by the kilometre.

Entire areas of production in the West have still collapsed, though, especially in textiles, footwear, household appliances, chemicals, timber, plastics and rubber. Thirty years of political passivity have produced a less rosy outcome than that promised by champions of pain-free deindustrialisation. France has had a trade deficit since 2004; the surplus in services does not compensate for the deficit in manufactured goods. Factory closures have turned whole regions into jobless deserts where technical skills have been lost. Service sector salaries, which were supposed to make up for job losses in industry, are on average 20% lower than those in manufacturing (1).

Some French manufacturers have been bringing production back home — ski manufacturer Rossignol, Kusmi Tea, clothing companies Paraboot and Le Coq Sportif — which shows delocalisation can be reversed. This may still be rare in France, but there are more examples of it in the US because of lower energy costs there, a desire for short production chains and a focus on high-tech products, which require minimal manual labour. Apple, General Electric, Caterpillar, Lenovo and Whirlpool did not wait for Trump's protectionist measures to bring some production back home; salaries were already rising in emerging economies, which are no longer content to be the workshop of the world and are investing in their own research and patents.

'The government should stay out of it.'

The state is neither a good manager nor a good stakeholder and should stop trying to direct industry. It should limit itself to enforcing competition law and creating a favourable climate

for growth by funding infrastructure and basic research,and educating the workforce of the future. The laws of the market will pick who is competitive and innovative enough to survive.

From the mid-1980s, French governments, resolute in their free market ideology (a founding principle of the EU), abandoned state intervention and stood by as the national industrial base crumbled. After Pechiney (aluminium), Arcelor (steel) and Bull (computing), leading firms such as Lafarge (cement) and Alcatel (telecoms) fell to foreign investors. It took the crisis of 2008, which revealed the financial instability caused by substantial external structural debts, for politicians to acknowledge the need, at least in principle, to re-establish domestic production capacity, though this was not enough to stop Alstom being dismembered and served up to the US giant General Electric (2).

The list of French national champions from the 'trenteglorieuses' (three decades of rapid growth post-1945) is enough to dispel the neoliberal myth that industry does not need the state. Ariane, Airbus, Corail trains, the TGV, the nuclear power programme and the national telephone network testify to the effectiveness of a state that strategised, directed and was unafraid to nationalise, plan centrally, and use state contracts and protectionism to rebuild and modernise the country (even if this process caused environmental damage that governments have been slow to address).

Not all projects worked. The Plan Calcul (to stimulate a national computing industry in the 1960s), Concorde and Minitel (a French antecedent of the Internet) are often cited by critics of technological Colbertism (state control of the economy). But the economist Jacques Sapir has shown that even these 'failures' provided positive learning opportunities. Supersonic air travel, though a commercial disaster, enabled 'the spread of knowledge and facilities in the French aeronautical industry ... vital to the later success of the Airbus programme' (3).

'Innovation always comes from the private sector.'

The state, hampered by bureaucratic lethargy, is unable to stimulate what the economist Joseph Schumpeter called the 'animal spirit' of creators. Only the market can enable innovators to emerge and give them the means to flourish. Is it any surprise that Silicon Valley is not a department of the US government?

The mythologised version of Californian entrepreneurs' pioneering spirit omits one fact: the private sector has never invested substantially in research when the outcome is uncertain. Economist Mariana Mazzucato (4) has shown that the most significant technological innovations of recent decades happened because of active state funding: the Internet was subsidised by Darpa (the Defense Advanced Research Projects Agency); GPS by the military Navstarprogramme; touchscreen technology by grants from the CIA and the National Scientific Foundation (NSF) awarded to two researchers from the University of Delaware; and Google's algorithm by the NSF. In the pharmaceutical industry, 'it turns out that a full 75% of the new molecular entities with priority rating are actually funded in boring, Kafka[esque] public sector labs. This doesn't mean that Big Pharma is not spending on innovation. They do. They spend on the marketing part,' she explained. 'They spend on the D part of R&D. They spend an awful lot on buying back their stock, which is quite problematic. In fact, companies like Pfizer and Amgen recently have spent more money in buying back their shares to boost their stock price than on R&D' (5). Start-ups and venture capital are important, but they come on board 15 to 20 years after the state has put up the bulk of the finance and shouldered most of the risk.

'Competitiveness means reducing wage costs.'

According to French finance minister Bruno Le Maire, 'we are not yet competitive enough, especially compared to our German neighbours. We need to open up the debate on reducing the burden of social security charges on salaries above 2.5 times the minimum wage' [France Inter, 26 November 2017]. This argument is 30 years old. In an open economy exposed to competition from emerging economies, French industry allegedly suffers from excessive labour costs, whereas Germany owes its success to a wage restraint policy implemented in the 2000s.

Since 1992, this diagnosis has underpinned social security exemption measures, such as the Competitiveness and Employment Tax Credit (CICE). It has been suggested that the reduction in labour costs brings down prices, increasing market share, improving margins, encouraging quality improvements and creating jobs. This is a version of the Schmidt theorem, popular since 1974: 'The profits of today are the investments of tomorrow and the jobs of the day after tomorrow.'

The crusade against labour costs eventually paid off. Since 2016 the hourly rate for French industrial labour has been on average €2.10 ($2.36) less than in Germany (6). But this is unlikely to be enough to stimulate French industry. Labour costs are not the cause of deindustrialisation. Those costs are offset by high productivity. If you divide GDP by the number of hours worked, France achieves almost the same level of output as the US and Germany. The main cause of French industry's lack of competitiveness this century is the strength of the euro. Between 2000 and 2010, the hourly rate increased by just 32% in euro terms, but by 90% when expressed in US dollars (7).

The decline of French industry over the past 30 years is also due to the internationalisation of large companies. While German companies have strengthened their domestic production bases, French firms have prioririseddelocalisation and foreign direct investment, especially in high-growth emerging economies. Consider the car industry: since 2006 French automakers have built more vehicles abroad than at home (domestic production has been falling since 2002), whereas German domestic output has kept growing. French multinationals employed six million people abroad in 2014, compared to the five million, 1.8 million and fewer than 1 million employed by their German, Italian and Spanish competitors.

Who can quantify the waste of wealth and jobs never created, of collective, social and environmental projects never started because of this insistence on profitability? *Laurent Cordonnier*

French manufacturers' decision to relocate abroad is in part due to their position at the middle and low end of the market, where competitiveness comes down to price, encouraging foreign production to cut costs. German manufacturers' competitiveness is non-price sensitive as it is based on quality and innovation, which enables them to set higher prices. In the opinion of economist Gabriel Colletis, a founder member of the Manifesto for Industry organisation, the Schröder government's (1998-2005) wage compression policy did less for competitiveness than for profits.

It is the cost of capital rather than the cost of labour that has driven France's deindustrialisation, as the big groups pay out an ever-larger share of their profits to shareholders, undermining investment and research. Thirty years ago, dividends were less

than 5% of the wealth created by industry; today they account for 25%. For every euro spent on investment in 1978, French firms paid out 50 cents in dividends. By 2011 that figure was €2.

Shareholder pressure forces companies to abandon investment projects deemed insufficiently profitable or engage in costly financial stratagems to meet the expectation of 15% profit margins. Colletis explains that 'as standard profit margins are in the region of 6-8%, companies are increasingly tending to buy up their own shares to increase their value.' This practice is widespread in the US and is becoming more common in France: between 1999 and 2015, €115bn ($129bn) was spent on it. In 2018 businesses in the CAC40 (stock market index of top companies) bought €10.9bn ($12.25) of shares. The total loss to the economy is impossible to calculate: 'Who can quantify the enormous waste of wealth and jobs never created, of collective, social and environmental projects never started simply because of [this insistence on profitability]?' said economist Laurent Cordonnier. If Bruno Le Maire wants France to be a great industrial power again, he could start by freeing businesses from the control of finance.

'Protectionism is dangerous and doesn't work.'

President Emmanuel Macron believes 'protectionism is war, it's a lie, a withdrawal' (26 April 2017). It is 'one of the two great global risks', according to the governor of the Bank of France, François Villeroy de Galhau (8): 'The increase in the price of imports has a disproportionate impact on less well-off households as they consume more imported products.'

History disproves the myth that protectionism leads to war and that 'doux commerce' (the theory that the capitalist spirit and drive for efficiency and profit create stability) favours peace. In 1870 France and Prussia went to war soon after signing a free trade agreement. There was no war during the 'trenteglorieuses', though it was an era of protectionism. The idea that it involves a national 'withdrawal' and the end of trade does not stand up to scrutiny: 'From the 1890s to 1914, all the industrialised nations apart from Great Britain pursued trade policies that were protectionist in spirit,' said economist Gaël Giraud. 'That in no way prevented the period from experiencing sustained growth in international trade (5% annually), to the extent that historians describe it as the "first globalisation" ' (9).

So how would it work today? Free trade advocates like to point out that because of globalisation poor households can buy cut-price t-shirts, toys and flat-screen televisions. Though it is true that a protectionist policy would increase the prices of imported goods, it might also end the obsession with the cost of labour that depresses wages: we'd lose as consumers but gain as wage earners. It would also free us from the compulsion to consume ever more useless products.

This does not mean supporting President Donald Trump's tariffs on Canadian aluminium and Chinese solar panels, which take no account of the consequences, such as reprisals, and the ineffectiveness of such measures in the absence of an industrial policy. Protectionism is not a magic wand that can revive any moribund industry; nor is it an economic policy: it is a tool that can serve conservative, unilateral, aggressive ends, or cooperative, green, social ones.

Advocates of 'protectionism for fairness' propose European tariffs should penalise imports from countries that flout salary, social, tax and ecological rules. The aim would not be to

support an ‘industrial Jurassic Park’ (10), but to protect new industries vital to the green transition and, beyond the industrial question, to bring about a fairer and more stable new global trade order. It’s not protectionism that leads to war; it’s the current deregulated system that sets competitiveness up as sacred and pits workers and national tax systems against each other in an endless race to the bottom.

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