The collapse of manufacturing

The financial crisis has created an industrial crisis. What should governments do about it?

$0.00, not counting fuel and handling: that is the cheapest quote right now if you want to ship a container from southern China to Europe. Back in the summer of 2007 the shipper would have charged $1,400. Half-empty freighters are just one sign of a worldwide collapse in manufacturing. In Germany December's machine-tool orders were 40% lower than a year earlier. Half of China's 9,000 or so toy exporters have gone bust. Taiwan's shipments of notebook computers fell by a third in the month of January. The number of cars being assembled in America was 60% below January 2008.

The destructive global power of the financial crisis became clear last year. The immensity of the manufacturing crisis is still sinking in, largely because it is seen in national terms—indeed, often nationalistic ones. In fact manufacturing is also caught up in a global whirlwind.

Industrial production fell in the latest three months by 3.6% and 4.4% respectively in America and Britain (equivalent to annual declines of 13.8% and 16.4%). Some locals blame that on Wall Street and the City. But the collapse is much worse in countries more dependent on manufacturing exports, which have come to rely on consumers in debtor countries. Germany's industrial production in the fourth quarter fell by 6.8%; Taiwan's by 21.7%; Japan's by 12%—which helps to explain why GDP is falling even faster there than it did in the early 1990s (see article). Industrial production is volatile, but the world has not seen a contraction like this since the first oil shock in the 1970s—and even that was not so widespread. Industry is collapsing in eastern Europe, as it is in Brazil, Malaysia and Turkey. Thousands of factories in southern China are now abandoned. Their workers went home to the countryside for the new year in January. Millions never came back (see article).

Factories floored

Having bailed out the financial system, governments are now being called on to save industry, too. Next to scheming bankers, factory workers look positively deserving. Manufacturing is still a big employer and it tends to be a very visible one, concentrated in places like Detroit, Stuttgart and Guangzhou. The failure of a famous manufacturer like General Motors (GM) would be a severe blow to people's faith in their own prospects when a lack of confidence is already dragging down the economy. So surely it is right to give industry special support?

Despite manufacturing's woes, the answer is no. There are no painless choices, but industrial aid suffers from two big drawbacks. One is that government programmes, which are slow to design and amend, are too cumbersome to deal with the varied, constantly changing difficulties of the world's manufacturing industries. Part of the problem has been a drying-up of trade finance. Nobody knows how long that will last. Another part has come as firms have run down their inventories (in China some of these were stockpiles amassed before the Beijing Olympics). The inventory effect should be temporary, but, again, nobody knows how big or lasting it will be.

The other drawback is that sectoral aid does not address the underlying cause of the crisis—a fall in demand, not just for manufactured goods, but for everything. Because there is too much capacity (far too much in the car industry), some businesses must close however much aid the government pumps in. How can governments know which firms to save or the "right" size of any industry? That is for consumers to decide. Giving money to the industries with the loudest voices and cleverest lobbyists would be unjust and wasteful. Shifting demand to the fortunate sector that has won aid from the unfortunate one that has not will only exacerbate the upheaval. One country's preference for a given industry risks provoking a protectionist

backlash abroad and will slow the long-run growth rate at home by locking up resources in inefficient firms.

Nothing to lose but their supply chains

Some say that manufacturing is special, because the rest of the economy depends on it. In fact, the economy is more like a network in which everything is connected to everything else, and in which every producer is also a consumer. The important distinction is not between manufacturing and services, but between productive and unproductive jobs.

Some manufacturers accept that, but proceed immediately to another argument: that the current crisis is needlessly endangering productive, highly skilled manufacturing jobs. Nowadays each link in the supply chain depends on all the others. Carmakers cite GM's new Camaro, threatened after a firm that makes moulded-plastic parts went bankrupt. The car industry argues that the loss of GM itself would permanently wreck the North American supply chain (see article). Aid, they say, can save good firms to fight another day.

Although some supply chains have choke points, that is a weak general argument for sectoral aid. As a rule, suppliers with several customers, and customers with several suppliers, should be more resilient than if they were a dependent captive of a large group. The evidence from China is that today's lack of demand creates the spare capacity that allows customers to find a new supplier quickly if theirs goes out of business. When that is hard, because a parts supplier is highly specialised, say, good management is likely to be more effective than state aid. The best firms monitor their vital suppliers closely and buy parts from more than one source, even if it costs money. In the extreme, firms can support vulnerable suppliers by helping them raise cash or by investing in them.

If sectoral aid is wasteful, why then save the banking system? Not for the sake of the bankers, certainly; nor because state aid will create an efficient financial industry. Even flawed bank rescues and stimulus plans, like the one Barack Obama signed into law this week, are aimed at the roots of the economy's problems: saving the banks, no matter how undeserving they are, is supposed to keep finance flowing to all firms; fiscal stimulus is supposed to lift demand across the board. As manufacturing collapses, governments should not fiddle with sectoral plans. Their proper task is broader but no less urgent: to get on with spending and with freeing up finance.

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