

TURN TO NEW INDUSTRIALIZATION: THE WORLD ECONOMY AND RUSSIA

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Abstract

The article analyzes the reasons for deindustrialization of the economy, that took place in the developed capitalist countries and in Russia, emerging under the influence of a hypothesis of ousting the industrial production by the service industry and, in the first place, its financial segment. The unfavourable consequences of the deindustrialization are identified; the need for reversal of the economic policy is substantiated; the major directions of realizing the new industrialization are outlined. The importance of reindustrialization is emphasized through the conceptual prism of realization of the course for development of a new technological revolution. The characteristic features of the new industrialization policy in the present-day Russian economy are revealed, with an objective to overcome its rent-specific and recourse-based nature.

Keywords: deindustrialization, financialization policy, industrial policy, new industrialization.

JEL code: L52

The world economic crisis of 2008-2009 and the difficulties of overcoming its consequences testify to the need for a substantial correction of the existing economic system. Its most characteristic feature is the reinforced dominance of the financial sphere with a possibility to earn high profits through speculative operations. It was regarded as a legitimate process of ousting the industrial sphere as obsolete and its replacement by a more promising sphere of services. However, this substitution resulted in increased instability and high risks in the economy, which predetermined the onset of a major crisis. Therefore, the return to economic stability and dynamism supposes the need to realize the goal of restoring a balanced interaction of the financial sector with the real production sector. In solving this problem, it is important to explore the conceptual substance of the so-called "service revolution", its tangible consequences and the reasons why reindustrialization in the developed capitalist countries and Russia is objectively required.

Service revolution and deindustrialization. Since the last third of the 20th century, the service sector has been growing worldwide, which led to the spike in its share in GDP production and employment. Still, the trend manifests itself in different ways as exemplified by the data on the change in employment patterns in two groups of countries: G7 and BRICS. Even these two groups that are far from being polar opposites exhibit noticeable differences.

World Bank (2013) suggests that employment structure significantly varies, especially when comparing leading capitalist countries with, for example, India, whose economy, out of all BRICS countries, is the closest to the standards of the developing world (see Table 1). The Indian economy is still characterized by the dominance of the primary sector (51.2% against 26.4% in the service sector), even though it is also experiencing employment shifts that correlate with modern economic trends.

Current shift towards the service industry is a natural process resulting from science and technology progress with its emphasis on the reduction of the share of human labor in areas of the economy where science and technology are actively employed. At the modern stage of development, its main manifestation is related to the results of information and computer revolution which underlie the popular economists' and political scientists' opinion

that the global economy shifted from the industrial to the postindustrial (or information) economic model. That conclusion, however, can be challenged.

Table 1. Employment structure in three economic sectors of developed countries and BRICS (1995-2012)

	1995			2005			2012		
	I	II	III	I	II	III	I	II	III
USA	2.9	24.3	72.9	1.6	20.6	77.8	1.6	16.7	81.2
Great Britain	2.0	27.3	70.2	1.3	22.2	76.3	1.2	19.1	78.9
France	4.9	26.9	68.1	3.6	23.7	72.4	2.9	22.2	74.9
Canada	4.1	22.0	74.0	2.7	22.0	75.3	2.4	21.5	76.5
Germany	3.2	36.0	60.8	2.3	29.7	67.9	1.6	28.4	70.0
Japan	5.7	33.6	60.4	4.4	27.9	66.4	3.7	25.3	69.7
Italy	6.6	33.7	59.8	4.2	30.8	65.0	3.8	28.8	67.5
Russia	17.3	33.1	49.6	10.1	28.0	61.9	8.8	25.5	65.7
Brazil	26.3	19.8	53.9	20.5	21.4	58.1	17.0	22.2	60.9
China	52.2	23.0	24.8	44.8	23.8	31.4	36.7	28.7	34.6
South Africa	14.3	27.9	57.9	7.8	25.5	66.6
India	61.9	15.8	22.3	56.1	19.0	24.9	51.2	22.3	26.4

Reference:

I – primary sector (agriculture + raw materials); II – secondary sector (processing industry);

III – tertiary sector (services).

(Source: World Bank: World Development Report 2013. Jobs. Washington, 2012.P.352-353)

The rise of the information sector in and of itself does not necessitate the end of real production and particularly the processing industry. Let us not forget that the first industrial revolution neither “closed” the agricultural segment, nor transferred it over into other sectors of the economy. Au contraire, it facilitated the industrial revolution in agriculture that resulted in widespread mechanization of agricultural labor. Therefore, postindustrial nihilism of modern industrial production should not be considered directly in the context of the unfolding information revolution, for such connection is a priori artificial and forced (Ryazanov, 2014). It is important to bear in mind that the very notion of substituting industry with services production has been proven wrong. With the development of the economy, its structure is not simplified, but becomes increasingly complicated due to the addition of new links.

Moreover, a number of other factors influenced the scale and pace of changes in the modern economic structure. Let us point out just two factors.

First, the modern stage of the service economy, especially its financial segment, is characterized by much higher profits compared with industrial production, which explains why not only the ruling financial elite, but also hired employees shifted their interest from the real sector of the economy to the service sector. For example, in the U.S. and Great Britain, banking, brokerage and insurance currently account for 35% of total corporate profits (compare with about 10% in 1960).

Brenner (2004) suggests that, over 1980–2000, in the U.S. the nominal value of financial profits increased more than 5-fold and reached almost USD 250bn per annum, while its share in total corporate profits more than doubled to almost 40% (see Pic. 1).

The financial segment of the economy saw not just higher profits, but also preemptive salary increases for its employees. While back in 1980 salaries in the financial sector were comparable to what other industries offered employees with the same qualifications,

nowadays financial officers average 70% more. Thus, high profitability and income boom drew capital to the financial sector and attracted the most active part of the workforce¹.

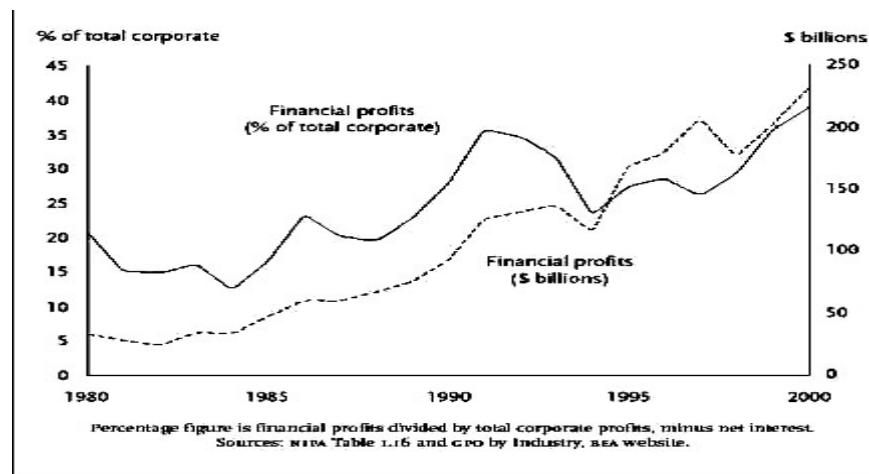


Figure 1. U.S. financial profits (USD billions, axis on the right) and their share in total corporate profits (axis on the left)

Source: Robert Brenner. The Trajectory of the US Economy // New Left Review- 25. Jan.-Feb. 2004

Second, the migration of industrial production to developing countries was driven by incommensurately lower costs, particularly due to much lower wages and social protection contributions, as well as lower taxes and looser environmental regulation. Personnel costs constitute the main expense in the cost of any product manufactured in the U.S. and exceed 50% and occasionally 60% of total cost. In the beginning of the 21st century, average hourly wage in the production sector was recorded at approximately 32 dollars in Germany, 17 in the U.S., 24 in Japan, 19 in France, 0.57 in China, and below 30 cents in India and Indonesia.

Consequently, developed capitalist countries virtually lost many traditional industries by moving production facilities to developing countries. Consequently, we have seen certain phasing out of mass production of basic goods that are the most essential items for most consumers. Deindustrialization resulted in a sharp drop in employment in the real sector of the economy. In the U.S. in late 1970s, industrial workforce amounted to approximately 20 mln people. By the spring of 2010, the number went down to 11.5 mln. By comparison, from 1990 to 2006, industrial employment in the People's Republic of China increased from 110 to 130 mln.

Textiles and clothing industries serve as a typical example of deindustrialization. In 1995, the U.S. employed 1.56 mln workers in these industries; in 2009, there were only 414,000. After international textile quotas were eliminated in 2005, China and other developing countries further strengthened their leading position on the market. Currently, the PRC is the world leader with a 40% share in exported finished products and textiles. At least 50–55% of the market belong to other countries that manufacture clothing for the U.S. and Europe, such as Vietnam (second behind the PRC), Indonesia, Cambodia, India and Pakistan.

The textile industry is but one example that illustrates the general trend. Other areas, including high tech industries, exhibited similar trends with the migration of mass production, especially components manufacturing, to new industrial centers.

For example, production of personal computers dramatically decreased in the U.S. with a little over 160,000 people currently working in the sector, while in East Asia computer

¹ Here and further examples on the following source: Ryazanov, 2016 b. P.283-285.

manufacturing supports 1.5 mln employees. The largest Chinese company Foxconn with the trade volume of USD 79 bn and net profit of USD 2.4 bn has over 550,000 workers, which exceeds the number of employees of all famous Western computer companies combined.

These examples disclose ambiguous results of the service revolution and allow for the conclusion that it would be more accurate to view the changes in the economic structure of developed capitalist countries as the effect of *the deindustrialization of the economy* with major negative consequences. Let us consider them in more detail.

Deindustrialization of the economy and its consequences. The first and most obvious consequence of deindustrialization in developed capitalist countries is the gradual loss of their leading role in industrial production. This problem was noted earlier (see World bank, 2012). The center of industrial development is increasingly shifting to Third World countries. (Table 2).

Dramatic reduction in the share of the U.S. industry in global production from 50% as of early 1950s to 20.7% in 1993 and 17.7% in 2012 reflects the intensity of the fight for economic superiority. The major decline in U.S. indicators highlights the spectacular rise of Chinese industry. Back in 1993, China accounted for 3.4% of global industrial production, but by 2000 the number went up to 5.9% and further increased to 14.8% in 2012.

For the world's leading countries, negative effects of deindustrialization manifest themselves in the following ways:

1) Shift in economic growth drivers towards dynamically developing countries. From mid-1990s until 2012, China and other developing countries accounted for more than half of global GDP growth, and the share of the U.S. and the E.U. shrunk to approximately 1/3. Current slowdown of economic growth exhibited by developing countries might result in further global market changes, but they most likely mark a new stage in the intensification of competition in the global economy.

2) Higher economic risks as the consequence of overestimation of export oriented model of economic growth based on narrow specialization in the international division of labor and the formation of global added value chains.

3) Bank for International Settlements (2015) suggests that segregation of the financial sector accompanied by augmentation of speculative component which leads to higher unpredictability and volatility and results in inevitable financial shocks in the economy. (See Fig. 2).

In 1993-2012, global industrial production increased by over 50%, but in the developed countries the increase constituted only 5%, while new market countries more than tripled their numbers, and China recorded a 7-fold increase. Since 2000, the industrial power of leading capitalist countries has been steadily dwindling, while most developed economies exhibited signs of stagnation of industrial production in stark contrast to its intensive growth in developing countries. Consequently, the share of seven industrially developed countries in global industrial production dropped from 62.2% in 1993 to 40% in 2012, while the share of the most dynamically developing new market economies increased from 14.7% to 28.6% over the same period of time.

Table 2. Industrial production (added value in USD billions and constant 2000 prices), 1993–2012

	1993	2000	2007	2012	2012 to 1993, %	2012 to 2000, %
Global production	8.722	10.851	13.391	14.144	162.2	130.3
Developed economies	5.423	5.745	6.194	5.693	105.0	99.1
USA	1.811	2.474	2.686	2.498	137.9	101.0
Japan	1.282	1.278	1.372	1.289	100.5	100.9
Germany	669	722	795	715	106.9	99.0
Great Britain	411	473	482	437	106.3	92.4
Italy	374	425	448	384	102.7	90.3
France	321	373	411	370	115.3	99.2
New market economies	1.279	1.901	3.142	4.047	316.4	212.9
China	297	640	1.395	2.087	702.7	326.1
India	96	152	265	342	356.2	225.0
South Korea	138	214	323	380	275.4	177.6
Mexico	196	269	298	304	155.1	113.0
Brazil	164	198	238	262	220.7	132.3
Indochina countries	173	246	350	398	230.1	161.8
Russia	215	182	273	274	127.4	150.5

Indochina countries: Indonesia, Bangladesh, Malaysia, Thailand, Vietnam.

Source: World bank (<http://search.worldbank.org>)

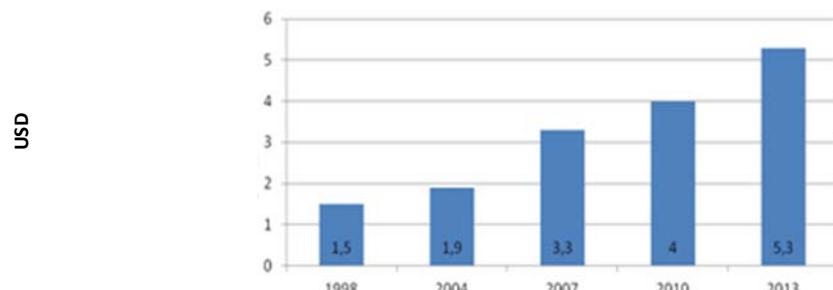


Figure 2. Average daily volume of global currency trading (USD trillions).

Source: Bank for International Settlements (<http://www.bis.org>)

4) Higher unemployment rate since the decline in the number of jobs available in traditional industries has not been compensated by positions in the new economy. In 1950-1970, unemployment in developed capitalist countries was brought down to 2.5-4%. Currently, in many developed countries the numbers have increased to 8-10%. (Not to mention the anti-record of Greece, Spain and Portugal, where unemployment is 25% and higher).

5) Economic security threats and the possibility of losing independent methods of control over internal economic processes in national production. In this situation, any country has the potential to become economically successful, but it would simultaneously acquire additional vulnerability areas by increasingly depriving itself of independent social and economic development. In other words, one can get richer, but will have to pay the price by becoming more dependent and vulnerable. Moreover, as the global economy recovers from the current recession, it is becoming increasingly difficult to build prosperity on borrowing and moving production facilities to developing countries.

Therefore, deindustrialization (which is now a historical fact) is the consequence of speculative financial revolution carried out under neoliberal globalization which resulted in the financialization of the economy as the idiosyncratic implementation of the program designed to increase profits of modern enterprises. Thus, transnational corporations bypass the state as an institution that hampers their dominance, which is why the aforementioned processes are intimately and intrinsically connected.

Some developing economies have been able to benefit from the reallocation of industrial production from the advanced world. But deindustrialization problem also negatively affects emerging market economies. Dani Rodrik shows that in such countries deindustrialization not only leads to the job losses, but also makes domestic producers' position on the internal market vulnerable. Even more damaging losses occur as a result of industrial underdevelopment influence on social and political processes in these countries. Deindustrialization impedes the progress of democracy and contributes to political instability (Rodrik, 2015, p. 23-24). That's what Russia actually faced.

Reindustrialization, its urgency and special characteristics in Russia. The trend for the deindustrialization of the Russian economy was set off by neoliberal market policies of the 1990s. Eager dismantlement of the Soviet indicative economy did not lead to the creation of an efficient market mechanism, but resulted in the general collapse of the R&D and production segment, especially in processing industries, along with the augmented focus on the primary sector. These reforms brought on a lasting social and economic crisis. Due to its systemic nature, the crisis was accompanied by huge economic losses, their scope and severity comparable to the aftermath of a natural disaster or military conflict. In August 1998, the national economy suffered an open default.

The government's subsequent adjustment of economic policies coincided with the beginning of a new cycle marked by the increase in the price of primary energy products on world markets. The budget nationalized part of the revenue from the export of raw materials and used it to support overall domestic demand, thus putting the national economy on the path to recovery. Still, that was not enough to curb the destructive trend and stop deindustrialization. It is important to point out that back in the beginning of 2000 scholars and officials established the urgency of transitioning from the model reliant on revenue from export of primary commodities to high technology economy and economy of innovations.

The results of the first pre-crisis decade only appeared positive, whereas realistically they left a lot to be desired, especially because the national economic recovery of 1999-2007 failed to perform the structural transformation of the economy. Moreover, the Russian economy immersed itself even further into the export of raw materials segment in the international division of labor. Instead of waning, the national economy's dependence on global raw materials markets only grew. Changes in the Russian export structure clearly support this claim. From 1999 to 2007, the share of raw energy products in the national export increased from 51 to 61.5% and, combined with other types of raw materials (metals, timber and lumber), amounted to 70.4% in 2008. If we take a look at innovative activity, it peaked in 2004 when 10.5% of companies were implementing innovations, but in 2008, the national average dropped to 9.6%. Thus, it comes as no surprise that in his 2009 address President Vladimir Putin stated that modernization of the Russian economy was a matter of Russia's "survival in the modern world."

It should be noted that during the period of double the fall in energy prices in 2015-2016 their export share declined in the years up to 54.7%. Accordingly, the share of revenues from oil and gas in federal budget income fell from 50% in 2012 to 36% in 2016.

All these factors underlie the need to prioritize reindustrialization of the Russian economy. Moreover, the urgency of the task at hand coincided with the substantiation of the

importance of overcoming global economic volatility and promoting the recovery of its dynamic potential. Such approach not only reflects traditional notions of economic development standards; its very existence and implementation are conditioned by economic powerhouses' desire to maintain their leading positions in the global economy. The two conditions predetermined relevant assessments and goals in analytical and program documents prepared by international economic institutions and experts.

For Russia, the exigency of neoindustrial economic shift was further triggered by Western sanctions introduced in response to the situation in Ukraine which happened to coincide with a sharp drop in the price of raw hydrocarbons on global markets.

These circumstances predetermined public consensus on the need to abandon the model reliant on revenue from the export of raw materials and implement active diversification policies. Nowadays topical discussions and alternative approaches focus *less* on the idea of an "energy superpower" and more on finding the most effective solution for the achievement of strategic economic diversification goals. This problem was noted earlier (see Gubanov, 2012; Bodrunov, 2016; Ryazanov, 2016a). But that also is a major point of contention.

The program of new industrialization in Russia should desist from contrasting the old (traditional) industries that are disappearing in the course of reforms and new (high-tech) production that is replacing them. The innovation sector should develop not by superseding traditional industries and production facilities of agricultural and industrial economy, but instead should ab initio emphasize their technical and technological modernization that would provide historically significant sectors of the national economy with a high tech and knowledge intensive face lift. At the same time, it is necessary to prioritize the source of current prosperity that will fund future neoindustrialization, i.e. the primary sector, and, consequently, focus on the development of its processing segment.

Such approach to diversification will allow for the restoration of a balanced economy that would comprehensively target domestic and external demand, which is a prerequisite for sustainable economic development. Since the implementation of a neoindustrialization program is inevitably a multi-stage and time consuming process, it will ultimately seek to secure a technical and technological breakthrough perceived as a strategic priority in Russia's economic development. Therefore, new industrialization will essentially transform into the implementation of major trends of the technotronic revolution that is developing worldwide. The issue here is how this strategic goal can be met quickly as the main link of the current economic policy without having restored the destroyed outline of industrial economy. If Russia tries to perform another leap, this time into the sixth technological order, bypassing the underdeveloped fifth order and ignoring the degradation of production, its national policy will be based on illusions and utopian projects.

An even more urgent and complex setback for the implementation of the reindustrialization program is the domination of speculative financial capital. The expansion of speculative financial capital is a vital problem for Russia as well. For example, the average daily volume of currency trading on the Moscow Exchange (MOEX+RTS) in the first half of 2016 amounted to approximately Rub 1.45 trillion, an almost 22-fold increase against 2005. By comparison, between 2005 and 2015, the volume of loans that Russian commercial banks provided to nonfinancial organizations has increased approximately 6-fold and reached Rub 30 trillion YoY. The ultrahigh activity on the currency market comes as no surprise, for in 2015 its profitability equaled 80%, which is exponentially higher than the standard 5-7% profit in the agricultural processing sector.

Thus, in order to perform the neoindustrial shift in the Russian economy with subsequent development of the new industrial revolution, we should implement radical measures for the reorganization and rehabilitation of the national financial segment. This

problem was noted earlier (see Ryazanov, 2016 b). Such readjustment can be introduced as part of the *socialization of finance* program.

What are the goals and advantages of the program?

The very structure of a socialized financial system in its usual sense can be perceived as the establishment of firm control and state regulation of speculative financial transactions. It is no coincidence that initially the implementation of the system was linked to the urgency of anti-crisis interference due to the part that financial market liberalization played in the global recession. Curiously, the idea was voiced by Western leaders at the height of the crisis, but once the acute stage had passed, it was quickly forgotten.

The main advantage of the project is that it stipulates the formation of a public-private financial system incorporated into the market economy and providing financial resources and services to private entrepreneurs on competitive basis through common instruments and with regard to economic conditions and tasks at hand.

Thus, the government can clean up the speculative mess and ensure general economic recovery, while the implementation of the program becomes a prerequisite for full-scale national neoindustrialization with subsequent development of a new industrial revolution. Socialization of finance provides the authorities with an additional resource for more active involvement in investment and innovation, which is of paramount importance for transitioning from the economy based on the export of raw materials to high-tech economy. Moreover, socialization of finance carries more profound and substantial meaning: it actually allows for the creation of a new mixed economic model as a feasible alternative to the reign of the neoliberal model of financial capitalism.

The formation of socialized (public-private) financial sector that interacts with the private sector in other areas of the economy constitutes the extended version of the mixture of different economic orders; such mixed formations existed in the past, and some can be observed nowadays, but in the a priori scaled down version due to the hegemony of neoliberal ideology and economic practices. The purpose behind the formation of socialized finance is the creation of a two-channel system for transferring savings into investments, where one channel functions under regular market conditions and encourages commercial banks and other financial institutions to extend credits to the real sector of the economy, while the other operates in the limited market and subsidizes priority projects, i.e., for Russia, projects related to import substitution and diversification of the economy.

For contemporary Russia, the development and implementation of socialization of finance is a prerequisite for the neoindustrial shift on a new knowledge intensive basis. Thus, the development strategy will be idiosyncratic. Since the program reflects objective need for a profound transformation of the Russian economy, it can respond efficiently to internal and external restrictions and limitations by overcoming stagnation and ensuring sustainable and balanced growth along with the achievement of social priority goals in economic development.

Thus, the advancement and realization of a course towards new industrialization makes it possible to implement the programme for overcoming the consequences of the crisis in conjunction with the necessary institutional changes in the sphere of finance. Its viability lies in the fact that development of the reindustrialization programme on a new science-driven basis would create favourable prerequisites for stimulating a new industrial revolution which makes it possible to respond efficiently to internal and external constraints, to overcome the existing economic stagnation and to secure sustainable and balanced advancement, with achievement of social priorities in the economic development.

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