"Manufacturing Matters:" [1]

A Critique of *Ontario in the Creative Age* Report

Introduction

Richard Florida and Roger Martin have attracted considerable media attention for their report to Premier Dalton McGuinty's Government on Ontario's economic and labour force prospects **--** not the least reason because the project cost Ontario taxpayers $2.2 million.[2] *Ontario in the Creative Age* published in February 2009 highlights Florida's "creative class" thinking and Martin's annual comparisons to industrial and demographic cohorts in U.S. states and cities. Both individuals are attached to the Martin Prosperity Institute and the Competitiveness and Prosperity Institute at the Rotman School of Management, University of Toronto.

Richard Florida, an academic economic geographer and popular author of the books: *Rise of the Creative Class, Flight of the Creative Class, and Who's Your City*, was brought to Toronto by Martin, the Dean of the Rotman School. Florida is a celebrity academic -- now famous for being famous – who started out a few years ago explaining the unalloyed beneficence of "professionals, artists and bohemians" for the economic welfare of American cities. Basically, he holds that creative people, including the presence of gay communities are most associated with economic growth, which is exemplified by social and business innovations, high-paying jobs and satisfying working and living conditions. Florida like most celebrities is inclined to speak as if he is the first one on the planet to observe the phenomenon of professional creativity. However, as we know, Harvard economist Joseph Schumpeter said most of what Florida offers close to a century ago.[3] Martin, having less celebrity status holds greater scholarly standing, and indeed is regarded as one of Canada's leading economic demographers; an academic who has specialized in comparing economic growth patterns in Ontario and U.S. states since 2002.

In *Ontario in the Creative Age*, Florida and Martin are in full flight. Their terms of reference from the Government of Ontario commissioned in 2008 set out the following:

> [To] undertake a study of the changing composition of Ontario's economy and workforce; … examine historical changes and projected future trends affecting Ontario, … and provide recommendations to the Province on how to ensure Ontario's

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[1] Cf. Stephen S. Cohen and John Zysman, *Manufacturing Matters: The Myth of the Post-Industrial Economy*, New York: Basic Books, 1987.

[2] Jennifer Wells, "Ontari-owe," *Globe and Mail*, Mar. 21, 2009, and Andrew Potter, "What you pay for a map with no roads?" *Macleans*, Feb. 19, 2009.

[3] Joseph A. Schumpeter published *The Theory of Economic Development* in 1911 and *Capitalism, Socialism and Democracy* in 1942. He taught at Harvard University.

> economy and people remain globally competitive and prosperous.[4]

Services 'First'

Creative Age immediately lays out the principal thesis of the report: the decades old shibboleth that agriculture and manufacturing are slipping away and the service sector is continuing to growth and dominate economies including Ontario's. The authors state on the first page of their report:

> Our economy is shifting away from jobs based largely on physical skills or repetitive tasks to ones that require analytical skills and judgment. This shift is also evident in the long-term trend away from employment in goods-producing to service industries, from occupations that depend on physical work to produce goods to ones that provide service and rely on creativity. The change is inexorable. We cannot turn away from it; nor can we slow it.[5]

The authors point to more than 80 per cent of jobs occupying the service sector, with a primary sector (e.g. farming, fishing and mining) that has been reduced from 42 per cent of total employment to 2 per cent during the period 1900 to 2006.[6] More recently, the authors report that from 1981 to 2006 "routine" jobs have declined in the workforce from 74 per cent to 70 per cent, and "creative" jobs have risen from 26 per cent to 30 per cent.[7] Martin and Florida characterize this latter period of change as "dramatic." And so the point of their thesis is: we all need to encourage the growth of "creative" jobs in the service economy. But, of course, the "dramatic" shift that they reference is merely 4 percentage points over 25 years regarding the decline of routine jobs, and a 4-point spread on the rise of creative jobs. Hardly dramatic.

Moreover the authors are a little late in the observation. Daniel Bell, an American sociologist, coined the term the "post-industrial society" in 1973, when he highlighted among other things that the service sector would dominate developed economies and manufacturing would continue to decline.

... But Manufacturing Matters Most

However, by 1987, political economists Stephen Cohen and John Zysman at University of California's Berkeley Roundtable on the International Economy (BRIE) took to task Bell's thesis and by inference the current Florida and Martin re-bake of Bell's 1970s idea. Cohen and Zyman crafted the "manufacturing matters" argument and pointed out in their fascinating book by the same title that the service sector "firsters" have it pretty much dead wrong. Far from the service sector providing the underpinnings of developed economies compared to manufacturing, precisely the opposite is true. They say in *Manufacturing Matters: The Myth of the Post-Industrial Economy*:

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[4] Roger Martin, Richard Florida et al., *Ontario in the Creative Age*, Martin Prosperity Institute, February 2009. p. iv
[5] *Ontario in the Creative Age*, p. 1.
[6] Ibid. pp. 9 (Exhibit # 4) and 7.
[7] Ibid. p. 7.

> … Our message is disturbing. Our tone is one of urgency, and our approach … is quite conservative. It argues against taking major and potentially irreversible risks on a basis of uncertain knowledge consisting of inadequately examined and unexplained economic data (mostly about employment in jobs labelled "services") and unproven and untried, albeit dominant economic theory.[8]

Cohen and Zysman point out that many business service sectors are "tightly linked" to manufacturing, not the other way around, because in effect the service sector *serves* the production of goods, i.e. manufacturing and food and natural resource production. I would add that to a considerable extent "services" serve manufacturing indirectly, that is, they serve goods consumption; indeed, the entire service sector operates to produce or maintain the usefulness of material consumption i.e. goods production and maintenance.

Cohen and Zysman also argue:

> Shift out of manufacturing and it is more likely that you will find that you have shifted out of such services as product and process engineering than into those services.
>
> Were [North] America to lose mastery and control of manufacturing, vast numbers of service jobs would be relocated after a few short rounds of product and process innovation, largely to destinations outside [North America], and real wages in all service activities would fall, impoverishing [our economies].[9]

They then pose a key question: "How important are upstream services to manufacturing?"[10] It turns out: really quite important. As far back as the mid 1980s when the authors were conducting their research, business services to manufacturing in the U.S. constituted "25% of GNP." Add this to the "value-added" direct contribution of manufacturing to GNP in America, 24%, and now you have a big number i.e. a combined influence of 49% on the American economy, not the traditional 20% figure that New Age prognosticators like to trumpet. Cohen and Zysman make the point forcefully:

> The magnitude if this estimation of the importance to the economy of upstream suppliers of services to manufacturers is so colossal that if it is even close to accurate it compels us to stop and immediately reconsider the treatment of manufacturing by conventional economics categories. *After all, manufacturing plus services sold to manufacturing firms equals half the economy* (my emphasis).[11]

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[8] *Manufacturing Matters*, p. 5.
[9] Ibid. p. 7
[10] Ibid. p. 22.
[11] Loc. Cit.

In fact, Cohen and Zysman argue that "some upstream service jobs are so tightly linked to manufacturing that they are best understood as direct extensions of that employment base."[12] Here the authors are thinking of the trucking industry "[that] specializes in interplant shipments of raw materials, components, and semi-finished goods," and, almost any other out-sourced and integrated activity including: payroll, human resources management, IT, marketing, design, and so forth.

Florida and Martin concede that the linkages between manufacturing and services are important but still they arrange the causal arrows running in the wrong direction. They say in *Creative Age:*

> The increasing sophistication of our services has contributed mightily to manufacturing productivity. Advances in software and communications services [have] improved forecasting accuracy for manufacturers and enabled the implementation of just-in-time production, which has reduced waste considerably. Industrial designers have increased efficiency through improved product and process design.[13]

Florida and Martin further concede that:

> Goods manufacturing in Canada and Ontario has become ever more productive over time. Across the economy as a whole, our manufacturers have been able to produce more value added output with increasing the number of employees. In fact, between 1997 and 2007 real manufacturing value added achieved growth of 1.0 percent annually, which the number of workers increased at a rate of 0.3 percent annually. This is the modern productivity miracle at work.[14]

Thus we see our *Creative* authors offering grudging concessions on the importance of manufacturing. In fact, Richard Florida had to confess to the *Globe and Mail* recently that "there's all kinds of manufacturing we can do that's interesting, but it's not going be the kind of manufacturing that we did before."[15] Before what?, we ask. We might be satisfied with these grudging concessions, except that the *Creative* authors reveal that "Ontario pays [in salaries] relatively more for increased physical skills "in manufacturing settings such as assembly lines and shop floors."[16]

While it *appears* Florida and Martin have done a 180-degree turn on manufacturing, the counter-factual myth-making has a full head of steam. Throughout their report the authors keep pressing the idea that we'll all be saved by creative talent in the service sector. "Ontario can

[12] Ibid. p. 23.
[13] *Ontario in the Creative Age*, p. 8.
[14] Ibid. p. 8.
[15] Jennifer Wells, "Ontari-owe," Globe and Mail, Mar. 21, 2009.
[16] *Ontario in the Creative Age*, p. 15.

become the world's first jurisdiction to engage in the transformation of the service economy to world-class standards; … the province should strive to have more than 50 percent of its employment in creativity-oriented jobs by 2030."[17]

Perhaps one of the most jarring aspects of the drive for a service dominated economy is the realization that so few services are tradable internationally. On this point, there can be no debate, international trade is by far characterized by exchanges in goods, manufactured goods, not business or professional services, and this central feature is not likely to change soon, in spite of the wishful thinking of New Age analysts. "Services constitute a very small proportion of our (American) international trade," according to Cohen and Zysman.[18] In the mid 1980s when our authors were making this observation, they pointed out that most "services" counted by statisticians largely included "foreign loans and investments," and real services like engineering, banking, or consulting services etc. accounted for only $7.5 billion, which would hardly offset America $36 billion merchandise deficit in 1984.[19] No country is going to become wealthy by trading in services. For all intents and purposes, productive international trade involves trade in merchandise goods, manufactured someplace.[20]

Manufacturing 'Dog' Wags the Service 'Tail'

In the end, we are all better off if we construe goods manufacturing (or for that matter primary resource production) as the dog that wags the service tail. And creativity or creative class "manufacturing" in services is also beside the point if we ignore the importance of manufacturing of goods as the core of our value-added economic activity. Aggregate 80-20 numbers on the proportion of services-to-manufacturing could not be less relevant if we are damning by inattention the canine that keeps our economic house in order – the tail of the dog being entirely insufficient to provide us with household comfort.

Even heterodox, development economists on the left get the concept. Erik S. Reinert in his recent book, *How Rich Countries Get Rich and Why Poor Countries Stay Poor* wants to know "why the real wage of a bus driver in Frankfurt is sixteen times higher than the real wage of an equally efficient bus driver in Nigeria?"[21] The answer is: the presence of manufacturing within close proximity; "capital is sterile without investment opportunities that are essentially the

[17] Ibid. p. 32.
[18] *Manufacturing Matters*, p. 29.
[19] Ibid. p. 31.
[20] But even this concern about what sector is on top, goods manufacturing or service provision, is ultimately beside the point, for as Cohen and Zysman argue "services are a not a substitute, or successor for manufacturing, they are a complement – one needs the other." Besides, as the authors note, quoting Nobel Laureate George Stiglitz: "There exists no authoritative consensus on either the boundaries or the classification of service industries." That's because the boundary between product and service can be so amorphous, for example: software may be a service or product; computer chips are goods, but what about firmware? And is publishing a newspaper a service or a manufacturing activity? Are reporters and editors manufacturers? We all get the idea. *Manufacturing Matters*, pp. 49 and 52.
[21] Erik S. Reinert, *How the Rich Countries Got Rich and Why Poor Countries Stay Poor*, New York: Public Affairs, 2008, p. 2.

products of new technology and innovations."[22] Citing the United Nations Conference on Trade and Development, "production is the core of human economic activity."[23] Reinhart argues:

> The fundamental idea here -- that a finished product might cost from ten to hundred times the price of the raw material needed for the product -- would recur for centuries in European literature economic policy. Between raw materials and the finished product lies a multiplier: an industrial process demanding and creating knowledge, mechanization, technology, division of labour, increasing returns and – above all – employment for the masses underemployed and unemployed that always characterizes poor countries.[24]

For Reinert the paradox of the bus drivers is found in baseballs and golf balls. Baseballs are made in the Caribbean and Central America where their "production" is unmechanized. Effectively baseballs are made by hand by an urban underclass. For the most part, wages are less than a dollar an hour U.S.; four balls are made per hour by a craftsperson, and they retail in the States for about $15.00 per baseball. Golf balls on the other hand are made in New England; the production is fully mechanized and high tech; regular R&D is undertaken. Direct labour costs run about 15 per cent of production costs and are in effect incidental to the production of baseballs. Baseballs are produced but not manufactured; golf balls are manufactured and direct labour receives 12-36 times the wages. Bus drivers in Honduras make a fraction of the wage of bus drivers in New England; the difference: they are services in close proximity to real manufacturing. Service wages "rub off" from manufacturing wages. And there's not much "creativity" involved in this fundamental economic reality.

Revitalizing Manufacturing

When auto and truck assembly wages disappear in Ontario, if there is not a good measure of Schumpeter's "creative destruction" going on i.e. new high tech jobs replacing assembly jobs or even new assembly jobs replacing old assembly jobs, the wages of the service industries in the province will drag down the wealth of the economy as a whole. Creativity – apart from applied technological innovation – doesn't hardly matter. If the manufacturing canine is not healthy and wealthy, his service "tail" withers away. Florida and Martin acknowledge as much. Quoting a report from Statistics Canada, the authors note:

> [M]ale workers between the ages of 25 and 49 who lost their jobs during the years 1983 to 2002 through [plant] closures or mass layoffs with the firms and subsequently found new jobs, were earning on average between 9 and 22 percent less five years later.[25]

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[22] Ibid. p. 67.
[23] Ibid. p. 69 and found in UNCTD, *The Least Developed Countries Report, Developing Productive Capacities*, 2006.
[24] Ibid. p. 87.
[25] *Creative Age,* p. 24. See also Rene Morissette, Xuelin Zhang, and Marc Frenette, *Earnings Losses of Displaced Workers*, Statistics Canada, Jan. 2007.

And the scope of the problem for manufacturers as a whole is not insignificant. Recently, professors David Conklin and Guy Holburn at The University of Western Ontario, Ivey business school compiled statistics on the extent of manufacturing's influence in Southwestern Ontario. Up to 21.5 per cent of employment resides in this sector in Southwestern Ontario, while the professional and technical services sector – the heart of the so-called "creative class" – comes in at 4.9 per cent; education employs 7.4 per cent in the region, and the news media and broadcasting by comparison employ 1.6 per cent.[26]

Shifting back to the auto sector, Dennis DesRosiers of DesRosiers Automotive Consultants Inc. wrote on June 3, 2009, elaborating on the severity of the downturn for auto and truck manufacturers in Ontario that:

> From a peak of 157,130 workers in January 2001, manufacturing employment in the automotive sector has fallen to only 99,684 workers in March 2009.
>
> ... Assembly sector employment has fallen to only 37,462 workers. It is the lowest level of assembly industry employment since the downturn in the automotive sector in the early 1970s when the energy embargo killed the sector for a couple of years.
>
> Parts sector employment has fallen to only 62,222 workers the lowest level since 1982. Much of the loss of employment is structural and is unlikely ever to return. Some is cyclical and will come back when the market comes back.
>
> ... I also include employment in the tool sector to give you an indication of how closely related jobs are also negatively affected with their employment down 21.1 percent to less than 20,000 jobs.[27]

This is sobering news for auto assembly and parts makers and of course the direct negative externalities for services is evident everywhere.

Conclusion

When economic developers come together in meetings and conferences over the next several months to plan for the post-recession period, the focus needs to be on revitalizing manufacturing. While the decisions for large manufacturers are often decided at distant corporate offices, much can be done on the ground in local municipalities across Ontario for small manufacturers. But we need to be prepared. Municipalities are often the difference between good

[26] David Conklin and Guy Holburn, *A Southwest Ontario Vision for Economic Competitiveness and Cooperation*, Southwest (Ontario) Economic Alliance, Sept. 15, 2008. Data is taken from the Ontario Ministry of Agriculture, Food and Rural Affairs, *Competition Advantage Database, 2008*.
[27] Email from Dennis DesRosiers, president of DesRosier Automotive Consultants Inc., June 3, 2009.

outcomes for local and prospective manufacturers and bad ones, and they need to get serious about removing many of the obstacles plaguing small manufacturers.

Economic developers need to become aggressive advocates of more flexibility in development rule-making, and to challenge complacency about high levels of local taxation. Moreover, our friends, the land use planners, are going to have to set aside currently fashionable nostrums in support of "smart growth" and "sustainable development," among other things.

Why? We are entering an era, a crucially important era, of *laissez-faire manufacturing*. Small manufacturers must be given the leeway to make unencumbered, independent and firm-centred decisions about expansion and new plant development. Excessive and overly-interventionist regulation and its evil twin excessive local taxation emphatically kill off job-making. If small manufacturers decide they cannot make a go of it because local governments are insistent on the Nirvana-like attributes of local regulation, or worse use the excuse of "provincial policy" mandates to turn away innovation and expansion, then we will be talking about Ontario's manufacturing recession for a lot longer than we should be.

If there are any in the economic development community still wedded to the notion that the service sector will save us from our current set-backs, and further that the service sector will actually bring us out of this recession, then Florida and Martin really will have pulled the wool over their eyes.

Back to the beginning: *Ontario in the Creative Age* is a false start. It is not just that the analysis is disjointed and muddled, its authors undermine the sector of the economy that generates our most important source of wealth creation; manufacturing is the sector that spins off the most "sustainable" wealth producing and employment opportunities we have.