Reindustrialising the United Kingdom

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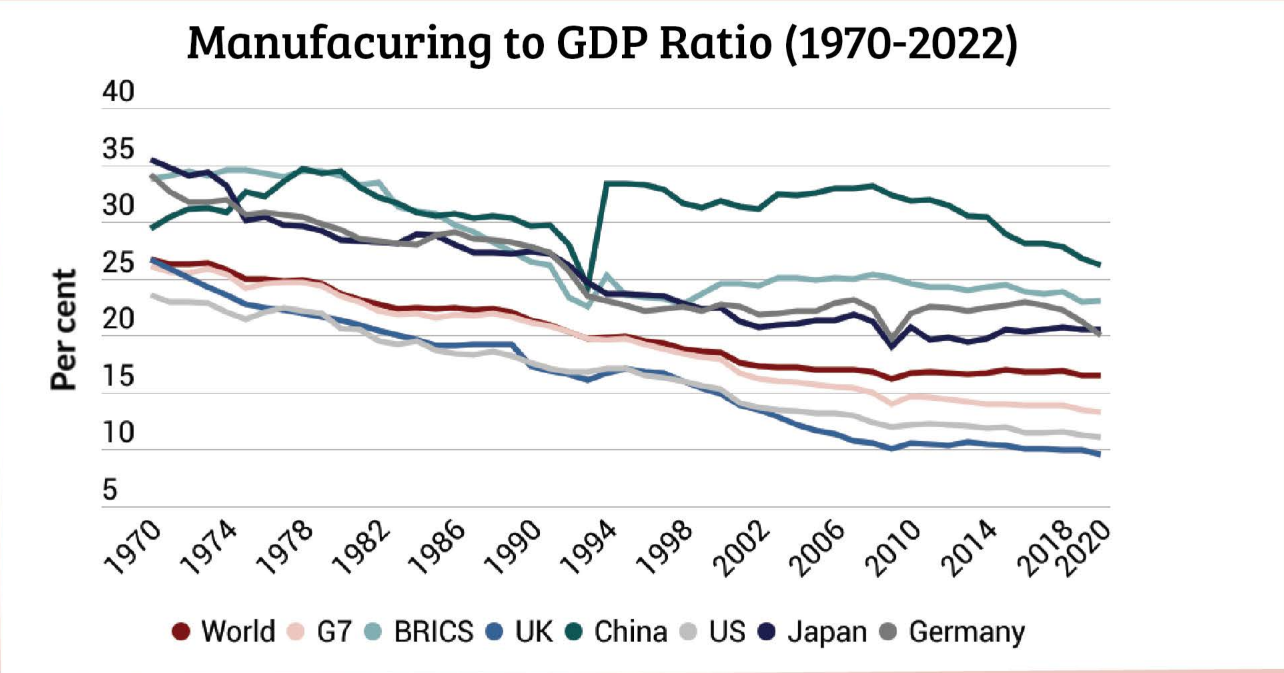
The purpose of this report is to examine the following two questions in the context of the United Kingdom:

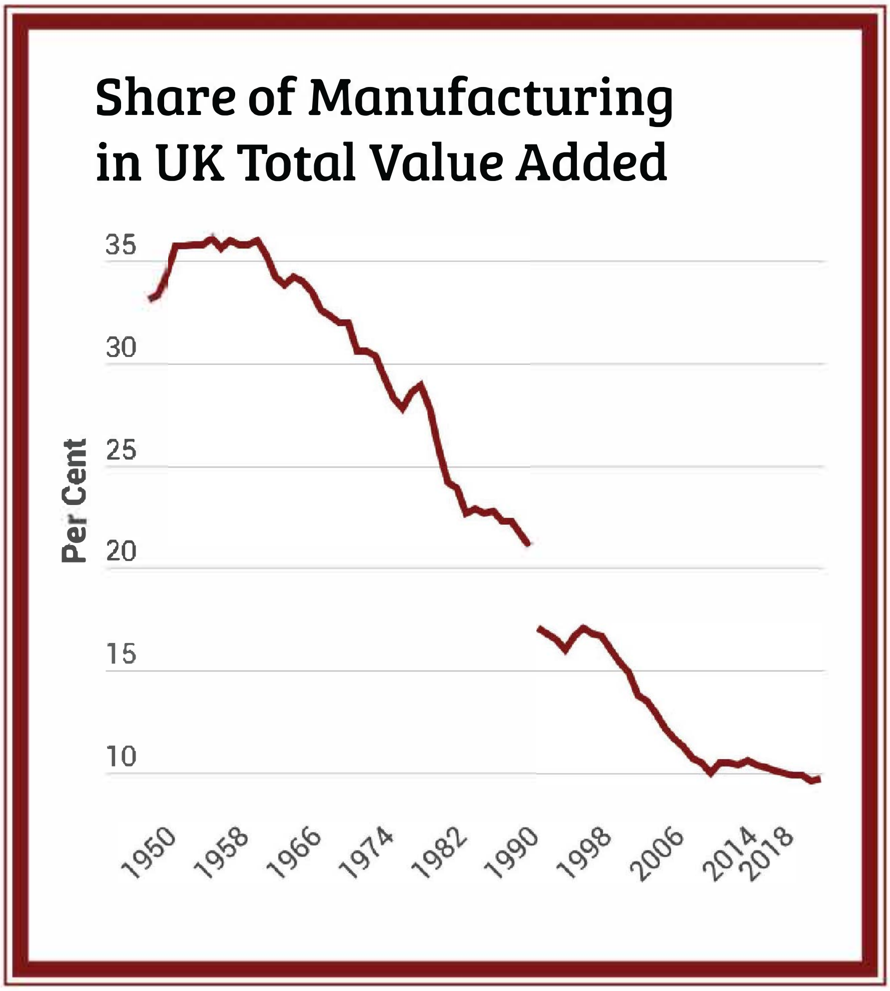
a. Can a lower exchange rate lead to an improvement in the economy's investment and growth performance?

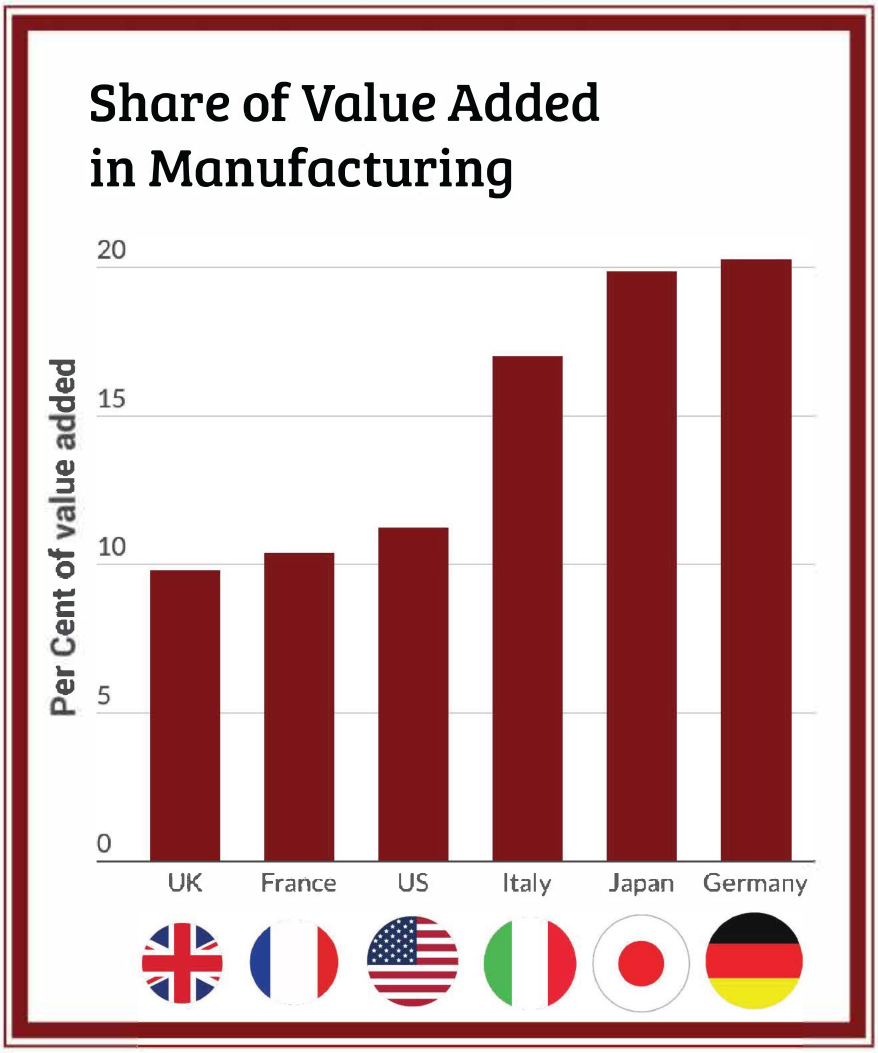
b. What are the conditions under which the exchange rate can be held at a low value?

As is well known, the United Kingdom has seen a long period of deindustrialisation, by which we mean a reduction in the share of manufacturing output in GDP matched by a rise in the share of services. The share of manufacturing output in UK GDP has fallen from around 35 per cent in 1950 to around 10 per cent today.

When people talk of 'the industrialised countries' they are talking about rich economies with high living standards. Industrial development has been at the heart of several countries' development strategies, including success stories such as Japan, South Korea, and China. Many of the fastest-growing economies over recent decades have seen rapid industrial development. Against this background, does it matter that the UK has the smallest share of Industrial output in GDP of any country in the G7? Or that it has seen the most significant decline in manufacturing share of all the G7 economies since 1970?







A large nominal exchange rate depreciation can lead to temporary increases in exports, investment and GDP at the expense of consumption. However, after a while these gains are **wiped out by rises in inflation** and, importantly, unit labour costs.

The empirical evidence from the United Kingdom, and the experience of China and Singapore, suggest that it is **not an overvalued exchange rate that explains deindustrialisation.** Rather, it is other factors affecting investment in **manufacturing and productivity growth** that are actually explaining both the **real and nominal exchange rate and the share of manufacturing in GDP.** That is, the exchange rate and manufacturing's share are both endogenous variables. The evidence simply does not support the contention that simply by **depreciating the exchange rate, an economy could bring about reindustrialisation;** other policies to support investment and productivity growth need to be in place.

A full copy of the report is available on the NIESR website: **niesr.ac.uk**