

RESHORING, REALLY?

Is the globalization wave starting to wane? Various recent indicators suggest that Western companies have started reshoring manufacturing jobs, those qualified and well-paid jobs that provided a social platform for the development of industrialized countries. But experts disagree on both the magnitude and the meaning of this phenomenon. Only on one fact do they agree: the United States will be the largest lab of the reshoring process.

The debate was launched in 2012 by a [momentous report](#) of the Boston Consulting Group (BCG) concerning the industrial renaissance of the United States. The report stresses on two facts: the reshoring of manufacturing jobs and the boom of American exports.

This well-timed publication was released in the midst of a presidential campaign during which the future course of employment played a key role. According to the BCG, the strong growth of U.S. exports, combined with the repatriation of a part of the production, could result in the creation of 2.5 to 5 million jobs in the United States by 2020. Gartner – a global leader in technology consulting – [states](#) that before 2014, 20% of finished products manufactured today in Asia and sold on the American market will be manufactured in the United States.

A tendency seems to emerge. But when taking a look at the official figures from the U.S. Department of Labor, one must admit that it still has to be confirmed. In the 1970s, there were 20 million manufacturing jobs in the United States. They were only 11.46 million left in January 2010, at the height of the crisis and, in June 2012, barely 11.96 million. It's a modest growth, but there is no denying that the pattern has drastically changed. Are we witnessing a simple stabilization or something more significant? That's the whole question today.

Comparative advantages

First of all, you need only to read the business press to realize that something is actually happening: for many announcements were made about the return back or the arrival of industrial firms in the United States.

Some of these decisions can be easily explained: the United States remains the biggest market in the world and major industrial firms have a strong interest in getting closer. This is the reason why, for instance, the British firm Rolls-Royce opened a new engine plant in Virginia and Airbus decided to assemble its A320s in Alabama.

But other decisions are more surprising. The most emblematic case is probably Toyota. The Japanese manufacturer has announced increasing capabilities of its plants in Kentucky and

Indiana, where the Camry sedans and Sienna vans are assembled. However these vehicles won't be sold in the United States, but in South Korea. Toyota is not an isolated case: Honda and Nissan are also planning to make vehicles in the U.S. and export them to Asia. The automotive industry is very special indeed: since the rescue of General Motors in 2009, this sector has received a lot of attention, both from the states and federal authorities that have led a tax policy in favor of the industrial sector. But this doesn't explain it all. Moreover, the automotive industry is not the only area affected by these industrial choices. In North Carolina for instance, Siemens has decided to build gas turbines that will equip a 4 GW powerhouse intended for Saudi Arabia.

These trade-offs reflect an already incipient reality which is expected to increase. Compared with their European competitors, but also to Japan or Korea, the United States have regained in competitiveness to an extent significant enough that it can weigh decisively during industry arbitrations. Let's take a look at the stats: in 2015, according to the BCG by using figures obtained through extrapolating tendencies since 2008, U.S. production costs will be 15% lower than in Germany and France, 21% lower compared to Japan, 23% lower compared to Italy.

These differences in performance can be largely explained by lower energy costs, and the gap is expected to increase even more. The shale gas effect will play in the hand of the United States: this nation has become a major – and almost autonomous – producer of natural gas. Manufacturers producing on U.S. territory pay their gas 50% to 70% cheaper than in Europe or Japan. This comparative advantage adds to other factors, including labor and electricity costs that are expected to increase in countries such as Japan and Germany after their decision to significantly reduce their share of nuclear power.

In terms of costs of exports, according to the BCG, in 2015, the United States will have an advantage between 5% and 25% compared to countries such as Germany, France, Italy, France, the United Kingdom and Japan. This advantage could redirect towards the United States between 2% and 4% of exports from four European countries and between 3% and 7% of Japanese exports. This corresponds to an annual saving of nearly \$100 billion in U.S. exports. These profits should focus on sectors that have traditionally offshored their activities: machine tools, transportation equipment, material and electrical equipment, chemical products, but also computers, electronics, appliances, electrical equipment, fabricated metals and furniture.

Compete with China?

These comparative advantages are significant when compared with countries with similar levels of development. But what happens with China, where so many U.S. manufacturers have relocated the manufacturing of their products in the 1990s?

A [more recent BCG survey](#) suggests that one third of U.S. industrial CEOs (from firms with more than a billion dollar turnover) manufacturing today in China are planning to bring their production facilities back to the United States or are considering to do so.

This is an enormous figure that needs to be explained. Several factors come into play. First, some of the comparative advantages that attracted these firms to China have vanished over the years: wages have increased by 15% to 20% per year while in the United States, they have stagnated. China suffers a shortage of skilled labor, which dramatically [raised the salaries of local executives](#).

Moreover, during almost thirty years, the rural exodus has offered a very cheap workforce to companies operating in China. New generation migrants are more demanding and less willing to be considered as second-class citizens who can be underpaid because of their poor protection by the labor law. This is good news for the Chinese people, but it certainly has a cost. According to the DNS Bank of Singapore, China has managed to control its labor costs until 2006, but since 2007, wages are increasing as fast – or faster – than productivity. Morgan Stanley estimates that rising labor costs in China will cause an overall additional cost of 1,500 billion over the 2012-2017 period for the industrial firms located in this country.

In 2005, as explained by BCG, it would cost 30% less to manufacture in China than in developed countries. By 2013, this gap will be reduced to 16%. With such a small gap – and it may very likely shrink to naught – risks of offshoring the production facilities will appear increasingly greater and more dissuasive: the rising price of oil, which adds endless transport costs; delivery times, too long for short-cycle products; difficulties in the coordination of teams located remotely; quality issues and non-compliance of the final product and the negative impact on the corporate image; corporate espionage and copycatting; import taxes and quotas. Not to mention other factors, foreseeable or not, that affect the decision of managers and investors: risks for intellectual property, piracy, natural disasters like the tsunami in Japan and floods in Thailand – the long list of accidents that may occur along the supply chain when it comes to crossing oceans.

A last factor can be pointed: the rise of “mass customization”: an increasing number of products are manufactured only when ordered – i.e. manufactured once the client has chosen his or her specifications. In this business model, it may be useful to get closer to the domestic market and minimize delivery times.

It is also recommended for companies that are often launching new products with short life-cycles. The Spanish fashion brand Zara never relocated its production to China and for analysts, this decision largely explains its outstanding success: it was able to capture – copy, according to forked tongues – trends in an extremely reactive way, by adapting its products faster than any competitors. In clothing, furniture, household appliances, where you must constantly renew products, reducing the time gap between design, production and distribution of products has become a major competitive edge and reshoring is sometimes the easiest way to regain control.

It is only when considering all of these factors that one can truly evaluate the pros and cons of reshoring industrial activities. Surely, the movement is underway. But what will be the next move?

The return of manufacturing jobs?

Depending on the country, the prospect of a complete reversal of globalization reassures or worries. It triggers also many fantasies: one must keep in mind that in the United States, as in most developed countries, relocations are only responsible for one-third of losses of manufacturing jobs. The rest is the result of technical progress.

Besides, regardless to its future scale, the current wave of reshoring doesn't exclude the offshoring movement. For a very simple reason: the consumer markets too are increasingly globalized. The rise of the middle class in major emerging countries converts them in extremely dynamic markets. The same reasons that make a firm have its production in the United States to be closer to its U.S. customers can also push it to manufacture in Brazil, closer to the Brazilians. In the third quarter of 2012, a report published by the consulting firm Hackett Group also confirmed a partial reshoring movement towards the United States. However, the same report added that the flow of outgoing jobs was still enough to outweigh these returns.

Finally, the issue of labor costs is not settled by the rise of labor cost in China. That's what historian and economist Tim Leunig (London School of Economics) recalled in a [memorable column](#) published by the *Financial Times*. For Leunig, the reshoring of jobs will simply never happen. First of all, Chinese wages will rise less quickly than expected. 34 million urban Chinese workers earn \$2 an hour in 2012, but they are still 65 million more working in inland towns for an average of 64 cents per hour. And even if one (distant) day, no Chinese worker were to be found to accept a two dollars an hour work, manufacturers would leave China for India, Bangladesh or Africa. This thesis is called itinerant offshoring: jobs migrate but do not return. In the early twentieth century, as reminded by Professor Leunig, Britain lost its textile industry to the benefit of Japan. When Japanese wages became too high, factories and jobs migrated to Hong Kong and eventually to Korea and China. They never came back to the United Kingdom.

To support this thesis, research labs of the University of Southern California have estimated that in terms of labor costs, China has surpassed the Philippines in 2012, will surpass Mexico in 2013 and is expected to surpass Taiwan in 2018 or 2019.

Needless to say that China does not and will not admit its defeat. In order to keep up in the race for productivity and quality, it is automating its production lines at great speed, even though this process implies huge investments at the cost of losing the competitive advantage of its cheap workforce – the most decisive advantage of Chinese economy during decades. The automation revolution that pervades China concerns robots but also machine tools using advanced digital controls. For Nomura Securities, China's equipment in terms of digital machines is still very poor. Today, they represent only 28% of the machine fleet, against 83% in Japan. But China is growing much faster than Japan during the same phase of its development.

Finally, as noted by Tim Leunig, Chinese productivity may increase by 10% per year; but it is still very low compared to the achievements of Western countries and Japan. This limits the employment benefits that can be expected from the reshoring movement. Leunig takes the example of the Chinese electronics industry, which employs 3 million people. If 10% of the production is repatriated to the United States, China will lose 300,000 jobs. However, only 40,000 new jobs will be created in the United States. Leunig made clever calculations: even if the entire Chinese manufacturing output was produced by American workers, the unemployment rate in the United States would only decrease by 2.75 percentage points.

What of the new industrial jobs?

The reshoring of manufacturing jobs in developed countries remains a challenge: the prospect of a return of industrial activities does not automatically mean massive job creation. So if the developed countries want to reindustrialize, what should they do? Wait for the offshored jobs to come back is not the right solution. Protectionism has also shown its limits.

Some researchers propose another approach. El Mouhoub Mouhoud, professor of economics at Paris Dauphine University and director of the CNRS International Research Center, promotes a kind of Copernican revolution in economic mentality: "Let's stop focusing on industrial employment alone. Let's also stop measuring the performance of a region only in terms of the number of manufacturing jobs it hosts. Let's take services seriously, at last. Especially the services of knowledge and immaterial investment for firms that represent, in a country like France, 12% of jobs – that's as much as the industrial jobs in 2012."

Mouhoud suggests reinstating a philosophy of services in the debate on industrial policy. The outlines of the industry must be redrawn keeping in mind that many of the relocated services belong basically to the industrial world: “Many medium-sized cities would see their economic importance increase if these services were better implemented. Moreover, the presence of these services is likely to attract industries and their subcontractors.” In short: a reversion of causality whereby the industry would cease to be considered as the sacred engine of economy. Industry could become a manufacturing version of a strategy that is primarily focused on services and design. This new reading grid, more suited to the contemporary economic reality, would also anticipate risks much better: for example, it would be very inadvisable for regions to mono-specialize in business support services... that could be highly offshoreable. In sum, offshoring will fuel debates during many years to come.

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