EMPOWERING AMERICAN CITIES

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Manufacturing Myth-Busters

Myth 3: Manufacturing Jobs Lost Overseas Are Gone for Good

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Through the Empowering American Cities project, we continue to argue that the Manufacturing sector is an undervalued asset in the portfolio of industries that make up any region's economy. Our three-part "Manufacturing Myth-Busters" series sheds light on this important part of our economy by addressing the major misconceptions about the sector. A proper framework for understanding the sector's past challenges is essential to understanding the future of American manufacturing. In our first Myth-Buster, we argued that manufacturing plays a productive role in generating prosperity in the 21st century and is a worthwhile addition to any region's economic mix. In our second installment, we took issue with the prevalent belief that the losses in manufacturing were due to productivity gains, making the case that trade played a greater role than generally believed. In this, our third and final Myth-Buster, we consider whether trade can now provide a tailwind, benefiting the growth of U.S. manufacturing.

This is the third in a series of three "Myth-Busters" challenging negative perceptions of U.S. manufacturing.

When former U.S. Labor Secretary Robert Reich wrote "Manufacturing Jobs Are Never Coming Back" for Forbes in May 2009, he explicitly based his outlook on the belief that productivity gains, not trade, had caused recent job losses. As productivity continued to rise, he argued, it would forevermore shrink the number of jobs in the sector.

We have argued that trade played a greater role and that the calculations that drove jobs offshore can shift to the benefit of domestic manufacturing. Reich's perspective seemed to dominate for a short time, but within a year of his prediction, manufacturing employment reached its nadir. Aside from the brief disruption during COVID-19, it has been steadily climbing since.

Why We Lost Manufacturing

The steepest decline in U.S. manufacturing employment occurred roughly from 2000 to 2010, when employment in the sector reached a post-World War II low. By contrast, global employment in the sector grew by tens of millions during this period. Assuming some U.S. job losses could be attributed to productivity gains, the question remains why manufacturing jobs grew elsewhere and not here. The answer is economics – a shift in opportunity, in costs and in profit. The many factors include a) access to foreign markets without incurring high transport costs, b) lower productivity-adjusted labor costs, c) cheaper energy input costs, d) tax advantages, and e) currency exchange rates.

Of course, trade deals that lowered tariffs and other barriers, including the North American Free Trade Agreement and China's entrance into the World Trade Organization, played a role in creating conditions that favored production abroad.

Trade itself confers many benefits, including lowering prices for consumers, promoting peace and fostering the development of domestic industries where the U.S. enjoys a comparative advantage.

China was the biggest benefactor but was just one of many countries that attracted manufacturing from the U.S. Other developing countries also built the infrastructure, stability and low-cost environment that nurtured new manufacturing plants and jobs. Notable gains in manufacturing employment were made, for example, in Indonesia, India and Vietnam, where manufacturing employment gains from 2000 to 2010 were 2 million, 9 million and 4 million, respectively. With or without trade deals, manufacturing employment shrunk in the United States and grew elsewhere. But that was then.

Shifting Cost Advantages

Many of the trade economics conditions cited above that have favored other countries over the past 25 years have shifted back and now neutralize the case for offshore production or in some areas actually favor American manufacturing. In many subsectors, there are clear cases to be made for some degree of reshoring or onshoring – in other words, for building U.S. manufacturing in lieu of foreign production. Here is a breakdown of some of the key conditions that have shifted, largely in support of domestic production:

A. Businesses had a powerful incentive in the first decade of this century to access the Chinese economy; annual Chinese GDP growth ranged from a 2001 low of 8.3% to a stunning 14.2% in 2007. While China still has a large and growing economy, its population growth is negative and its economy is expanding at roughly half the pace it did in the 2000-10 decade. The buildup on manufacturing to access the Chinese consumer is potentially less urgent today and already close to saturation.

B. China, for example, has made strides in productivity, but rising labor costs have reduced its cost advantage over the U.S. From 2000 to 2018, Chinese manufacturing productivity grew by 10.4% annually, while labor costs increased by 15.6% each year. By 2023, manufacturing in China was only about 4% cheaper than in the U.S., compared with over 13.5% cheaper in 2004, according to the Boston Consulting Group. By the parameters of this index, some countries remain quite "cheap," but nothing approaches the combination of low cost, high capacity and high potential that China offered in the first decade of the 21st century.

C. Energy cost and reliability shifts strongly favor production in the U.S. for energy-intensive manufacturing. Chinese electricity costs, based heavily on coal-fueled generation, remain slightly below the U.S., yet horizontal drilling and fracking has revolutionized American gas production, dramatically increasing energy supply reliability and price stability. Natural gas abundance supports American chemical manufacturing in particular. The energy reliability and cost advantages play most strongly compared with Europe. The 2023 update to the BCG Manufacturing Competitiveness Index shows not a single European nation is "cheaper" than the United States.

D. In the period of greatest manufacturing job losses, the highest marginal corporate tax rate was 35%. Today it is 21%. Lower corporate taxes support a favorable business climate, allowing companies to retain more of their earnings and hire additional workers.

E. Only in currency exchange rates has the case for American manufacturing weakened. A strong U.S. dollar disadvantages American manufacturers because U.S.-made goods become expensive in foreign currency terms. Conversely, goods produced abroad are less expensive to dollar-based buyers. Since 2010, the dollar has appreciated over 40%, a significant impediment for U.S. exports of domestically produced goods.

Beyond Traditional Cost Equations

Price is only one component of the manufacturing equation. Rule of law, intellectual property protections and political stability also influence decisions on whether to locate manufacturing outside the U.S. Supply chain resiliency came under particular focus during the COVID pandemic. For nearly two years, the New York Fed's Global Supply Chain Pressure Index remained elevated at levels not otherwise seen in the quarter century of data.

National security considerations are adding another argument for creating more U.S. manufacturing capacity. The CHIPS Act, provisions of the Inflation Reduction Act and proposed tariffs are all policy reflections of these concerns. Such policies lack the flexibility and permanence of market forces, but they point in the same direction: more U.S. manufacturing jobs.

Policy responses aside, the desire to reduce supply chain risk has led to business strategies that ultimately favor more American manufacturing. An increasingly common strategy is for firms to not merely reshore but dual-shore (have a domestic supply source to fulfill part of the needs, even if more expensive) and ally-shore (reduce supply chain reliance on U.S. adversaries).

The Evidence of Reshoring

Except for the COVID disruption, manufacturing employment gains since 2010 have been steady but modest. In the past year, amid a global manufacturing stall, U.S. employment in the sector has slightly retreated. Yet forward-looking indicators of manufacturing growth are more promising.

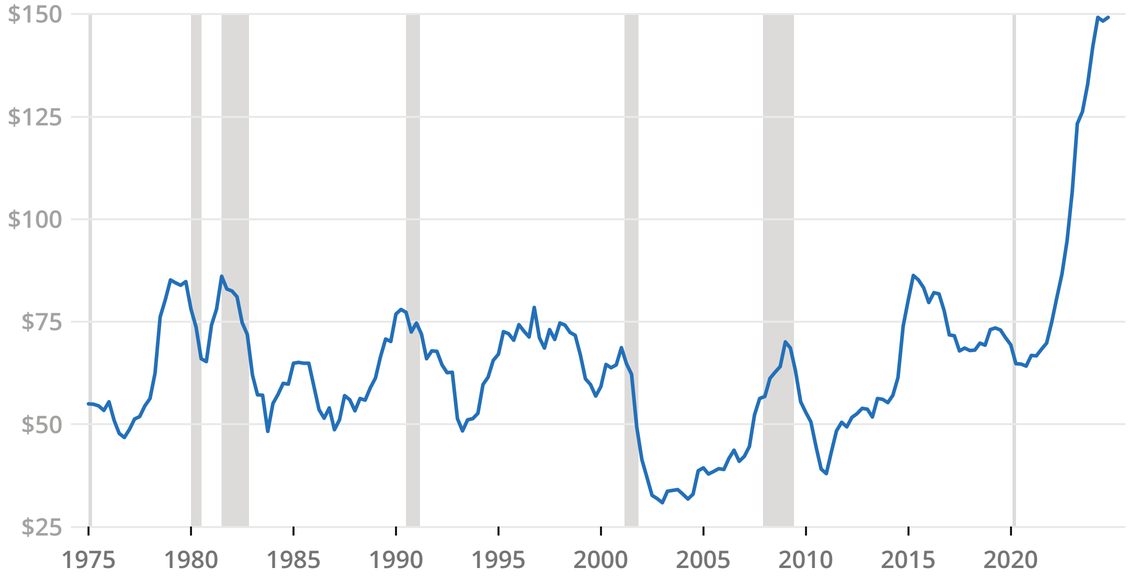
Construction spending on manufacturing facilities has soared since the beginning of 2022. In recent years, we've seen a rapid increase in inflation-adjusted spending by private businesses on new construction, improvements and equipment for manufacturing facilities. Both supportive policies and demand for domestic manufacturing capacity have contributed to this uptick. Perhaps a harbinger of further investment to follow, public company mentions of "reshoring" also continue to rise.

Local Market Opportunities

While national trends support reshoring, some regions will experience greater benefits than others. As a rule of thumb, Extended Metropolitan Areas – cities and the surrounding economically linked counties – that already support an infrastructure and culture of manufacturing are best positioned. Local leaders can enhance their prospects by ensuring an ecosystem that attracts manufacturing investment. Policy certainty, permitting ease and educational institutions that support the training needed for a manufacturing workforce are

Construction Spending on Manufacturing

Seasonally Adjusted, Billions 2017$



Source: Bureau of Economic Analysis

the most salient concerns for companies looking to reshore productions. The Dayton Region Manufacturers Association, for example, has in recent years actively leveraged the area's skilled labor force and proximity to diverse markets across the U.S. to attract reshoring initiatives. At the same time, Chicago has tapped into the area's higher education systems to improve skills development for its manufacturing workforce. For example, Daley Community College's program in advanced manufacturing provides training and certifications for in demand advanced manufacturing roles, and offers a pipeline for Associate's Degree holders to transfer into Bachelor's degree-earning programs.

Conclusions and Expectations

To believe in the future of American manufacturing is not to believe we will return to the heady days of post-WWII America, when manufacturing accounted for 1 in 3 jobs and the United States was the "workshop to the world." As the world grows wealthier, its citizens tend to spend more on manufactured goods in absolute terms, but less relative to services, and employment trends follow suit. Reasonable aspirations would be to grow manufacturing jobs with a goal of approaching 10%-15% of total employment. For context, manufacturing employment is 15% of total employment in Japan, 20% in Spain, and 27% in Italy while it accounts for only 8% of total employment in the U.S.

As we argued in our first installment of the Myth-Busters series, manufacturing adds a lot to a local economy's prospects for prosperity. Pathways for diverse employment candidates, good pay and high multiplier effects show why manufacturing is worthy of investment.

In this final installment of the series, we conclude that growing this fruitful sector is not only possible but also imperative and, under the right conditions, a likely outcome.

For more information on **Empowering American Cities**, please visit our website.
More reading on manufacturing in the new economy:

Manufacturing: Regional Strengths and Shifts (Redux)

Electric Vehicles: New Cars, New Regions and New Challenges