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Why Job Reshoring Is Merely a Trickle

U.S. manufacturing can't compete on cost, but it has a leg up in some areas.

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Yes, jobs are returning to the U.S., many of them in manufacturing. That's welcome news after decades of corporations transferring production overseas, particularly to China. In 2022, manufacturing ranked fifth in job creation among industrial groups, yet a decade before, it was last and falling fast, losing 16% according to government statistics.

But this reshoring, as the in-migration is known, is still a trickle and concentrated in high-end sectors such as autos. No one expects the nation, despite its predominant economy and high productivity, to return to anywhere near the manufacturing leadership it enjoyed after World War II. Nor to resurrect blighted factory towns across the face of America, known as the Rust Belt.

The cold fact remains that U.S. factory wages remain far higher than those in China and emerging markets, which gained at the American industrial workforce's expense: almost $27 per hour, on average, in 2020 in the U.S. versus $6.50 in China and $3 in Vietnam. The first big beneficiary of America's job exodus was Mexico, where numerous U.S. auto plants opened over the past four decades. In Mexico, the 2020 average hourly pay was just under $5.

The upshot is that reshored jobs are still a mere fraction of overall domestic employment increases. An estimated 351,000 jobs returned to the United States last year, counting some from employers that weighed expanding overseas and then opted for the U.S.—GE Aviation is one example. That's up sevenfold over 10 years, according to the Reshoring Initiative, a study group funded by U.S. manufacturers.

So reshoring has a lot of fans, and it has high expectations. "Reshoring will reduce the trade and budget deficits and make the U.S. safer, more self-reliant and resilient," said Harry Moser, the founder and president of the Reshoring Initiative, in a statement.

At first blush, that 351,000 number seems pretty impressive: It's only a little less than the country's 390,000 manufacturing employment increase in 2022. Still, more broadly, the nation saw more than 6.4 million new hires in January 2023 alone. And manufacturing contributes only around 11% of U.S. gross domestic product, down from 28% in 1952.

The labor cost differential is a big barrier preventing reshoring from turning into a major movement, a number of analysts say. "Overall, some manufacturing will move back to the U.S., but at the expense of higher cost," says Andrew Palmer, CIO of the Maryland State Retirement Agency, which has substantial international investments.

Meanwhile, there is a labor shortage developing in the country, a problem that in the past would likely have been solved by immigrant labor. Palmer adds that “the degree of onshoring will be constrained by the labor force in the U.S., especially in the absence of effective immigration reform.”

At present, reshoring is just a small cross-current in the domestic economy. “The talk so far has run ahead of any action,” notes Cameron Brandt, director of research at data firm EPFR. Many U.S. offshore operations, for instance, find that uprooting themselves to decamp for home is financially onerous, if not impractical. They typically will have large amounts of factories and equipment to dispose of, which is expensive and difficult, Cameron points out. Many believe Apple’s enormous dependence on China to make iPhones will keep the tech giant embedded there.

Talk of reshoring is taking place against a backdrop of declining world trade, which receded to 57% of global economic activity in 2021 from 61% in 2008, its peak, per World Bank data. This reversal of the long-running globalization trend came as China-U.S. relations soured, the war in Ukraine sparked sanctions against Russian goods and other frictions surfaced, most notably Great Britain’s messy exit from the European Union. The pandemic for a time snarled supply chains, most prominently between Asia and North America, which in turn prompted interest in shortening them.

Adam Smith Rewired

Why is this happening now? The 18th-century economist Adam Smith ginned up the concept of “comparative advantage,” meaning nations should specialize in what they do best. In his day, England excelled at producing textiles (due to its superior industrial technology) and Spain at making wine (thanks to its climate), and the idea of English wine was a non-starter.

In modern times, China, Mexico and other emerging markets had a powerful advantage owing to their cheap labor. Ross Perot, when he ran for president in 1992, warned of a “giant sucking sound” from Mexico’s wage level enticing American companies south of the Rio Grande.

Since the Cold War, the guiding principle of international relations was that armed conflict was antiquated, universal good will and capitalism would bring prosperity for all, and nations could co-exist in a benevolent free-trading climate. Sure enough, international interdependence flourished, creating an Adam Smith wonderland. Or so it seemed.

It turns out that trans-national ties were a bit too entangled, many analysts and historians have concluded. The 2008 collapse of an easy-credit-fueled U.S. housing boom was the catalyst to a global economic catastrophe. Toxic American mortgaged-backed securities and the derivatives they spawned wreaked financial havoc everywhere, boosting inequality and fostering protectionism, an International Monetary Fund analysis found.

China grew distrustful of the American-led economic model following the crisis, then tightened dictatorial control of its people and acted belligerently. Russia did the same and actually embarked on a war of conquest. Many Americans weren’t pleased with the pre-2008 status quo, either. Before the crisis, “investors benefited from the efficiency” of free trade, says Fall Ainina, director of research at James Investments. “Regular people didn’t.”

Result: Smith’s dream of a bounteous free-trading globe, benignly tolerant of comparative advantage, has been updated. Now, making stuff closer to home is much more appealing. But his original theory still has relevance, to a degree. No one is talking about reshoring the manufacture of everyday items such as shoes to the U.S. China remains by far the leading exporter of footwear, with 12 billion pairs produced in 2021. Likely, it will continue to own that crown.

Given all the world's recent turmoil, factors other than low costs have come forth to modernize Smith.

Reshoring Soaring, Sort of

During Donald Trump's presidency, tariffs, mainly against China, were aimed at sheltering U.S. industry, although the strategy's record is debatable. This decade's pandemic economic disruptions and international tumult laid the stage for President Joe Biden's multi-billion-dollar plans to bolster weakened areas of the nation's economy via subsidies and tax breaks: the CHIPS and Science Act to increase semiconductor production and innovation, and the Infrastructure Investment and Jobs Act to rebuild the sagging U.S. transportation arteries, so vital for commerce and consumers.

Indeed, some companies are pulling out of China. Their pullback, however, generally results in a move to low-cost Asian nations, with Vietnam a favored destination. The problem is that Vietnam and its ilk often lack the infrastructure to accommodate huge industrial operations. Thus, a companion inclination to reshoring is what strategists call "friend-shoring" or "near-shoring." That basically means moving production to Mexico, which has a long history of building items such as vehicles and consumer electronics for American companies.

Mexican labor is cheap, and transporting its goods to the U.S. is a breeze, observes Harry Hewitt, a portfolio manager for global equities at Mondrian Investment Partners. "Better to have it [nearby] at less cost than not to have it at all," he says of relocated manufacturing south of the border.

Nonetheless, some manufacturers find they are best off building their wares in the U.S. In some cases, an American location even beats a Chinese one. As Maryland CIO Palmer explains, "China has become more expensive and, after shipping costs and incorporating quality advantages, the U.S. has made more sense economically in some industries."

How Far Will This Trend Go?

Much of this repatriation is concentrated on high-end manufacturing operations, such as microchips and automation robotic devices. "They are building the brains of a factory, not its pumps," said David Klink, a senior equity analyst at Huntington National Bank.

Example: Rockwell Automation, which split from its aerospace operations two decades ago. In announcing a strong quarter ending in December 2022, the company attributed its success in part to the easier access available by serving reshored U.S. manufacturing companies. It projects comparable sales to grow between 11% and 15% in its fiscal 2023, which ends in September.

Auto plants have long been the cream of American heavy industry. Foreign automakers, including BMW and Hyundai Motor, are continuing to open new factories in the U.S., reasoning that assembling their cars in the world's biggest vehicle market makes sense. Ground shipping outlays for U.S.-produced goods are way lower than ocean transport. Factories for electric vehicle parts are also growing on the American job scene, including non-U.S. companies: Ford Motor and South Korea's SK Innovation are building a massive battery factory in Kentucky.

But back to those pesky American wages. Reshoring won't be any bargain, a reality that many predict will hinder its impact over time.

“Reshoring costs will likely be borne by shareholders, consumers and the government,” investment firm Cresset Capital Management wrote in a research paper. “Domestic manufacturing will incur higher labor costs, due to a shortage of skilled labor and a relatively more expensive labor market.”

Whatever Smith might think of today’s U.S. reshoring issue, the swing is underway, and the only question is how far it will extend.

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