Is re-industrialization the key?

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Most economists agree that the “Great Recession” of 2008 ended sometime around August 2009, and while the economy has been slowly recovering, unemployment still appears to be a stubborn problem. The headline rate is just a shade under 8 percent, which translates into a little over 12 million Americans out of work. But an alternative measure of unemployment, U6 (total unemployed, plus all people who are working part time for economic reasons, plus all people who are only marginally attached to the labor force), stands at an incredible 14.4 percent.

A study by the National Employment Law Project (NELP) found that most of the job losses that occurred during the recession were in what we would consider mid-wage occupations. And slowly but surely, as the U.S. works its way out of this prolonged economic slump, new jobs are being created. But unfortunately, most of the jobs created during the recovery have been in sectors that we would consider as lower-wage occupations (primarily service jobs).

With consumer spending accounting for roughly two thirds of the U.S. economy, a lack of good paying jobs does not bode well for a sustained and robust recovery.

Historically speaking, manufacturing jobs have, on average, paid better wages than service jobs (with the former usually providing better benefits as well).
But manufacturing, as a percent of the economy, has been on the decline for decades now. Over 5 million manufacturing jobs have been lost since 2000 alone.

But is this an irreversible phenomenon? A new study out of the Massachusetts Institute of Technology (MIT) gives encouragement to those who believe that revitalizing American industry would be good for the economy, while at the same time creating high skilled and higher-paying jobs. Researchers at MIT suggest that efforts be made to maintain, and rebuild, the country’s manufacturing base.

The report also calls for a new point of view regarding what we refer to as "manufacturing." Instead of thinking of it as something in decline and only to be found in the Rust Belt, it should be viewed as a dynamic and evolving group of industries that are a source of new ideas and new skills, as well as new products. Moreover, manufacturing should not be seen as something that is out of place in the service / knowledge based economy of the 21st century.

The researchers also call for efforts to be made to develop the country's capacity for innovation, which they see as being closely interconnected with manufacturing.

The study involved closely examining the operations of 255 manufacturing companies (178 were in the U.S.), with an emphasis on finding out what drove innovation in these firms. It also wanted to know, of the key elements that are critical to success — capital, skilled workers, suppliers and expertise — which had been the hardest to find.

The research group interviewed managers at four types of companies: U.S. based multinationals that had made large investments in research and development; start-up firms; local small-scale "Main Street" operations; and foreign companies in China and Germany.

One finding that could be troubling to people promoting a strictly knowledge-based economy for the U.S. was that when companies separated the design elements of their products (keeping the high value adding activities in the U.S.) from the actual manufacturing (outsourcing the production to a low wage country like China), opportunities for improved efficiencies and design were lost. This might give pause to high-tech companies who have been outsourcing their production overseas.

The importance of mutually reinforcing clusters of companies was also found to be a key element for success. The report talks about how "production ecosystems" provide what MIT calls a "proximity effect," providing complimentary resources such as training and valuable know-how, as well as worthwhile opportunities for collaboration and mutually beneficial research, usually between private companies and public institutions (like universities).

President Obama, for his part, says that he is committed to revitalizing manufacturing and using it as a platform for creating more better paying jobs. The Obama administration said it wants Congress to approve a $7 billion package — $6 billion in federal tax credits for factory towns that are in need of help and $1 billion to create innovation hubs. As part of the plan, the White House intends to promote manufacturing innovation institutes. Ideally, these would be centers which would promote collaboration between businesses and universities.

The President's program includes:

- Creating a network of 25 manufacturing Innovation Institutes
- Making changes to the business tax code, lowering the tax rate for manufacturers to 25 percent and expanding, and making permanent, the research and development tax credit
- Promoting and building new partnerships with communities to attract manufacturing companies and their associated supply chains
- Increasing efforts to open new markets for American-made goods

The plan, if implemented, would tie in nicely with some of the findings of the MIT report, which calls on new types of collaboration and risk-sharing, namely through joint public-private partnerships and industry-university agreements. All of this should go a long way to promoting, and revitalizing, manufacturing in America.

There are also several trends going on right now that could favor the re-industrialization of America.

BCG, a consultancy, estimates that China's average cost of labor has been rising anywhere from 15 percent to 20 percent a year. BCG argues that we are on the verge of a second industrial revolution. The major driving force behind this is a convergence between the wages of the highest paid Chinese workers and those of the lowest paid American workers. True, Chinese wages average just 10 percent of those found in the States, but when one calculates the total cost of a good (design, fabrication, logistics, supply chain management, quality and so on), a strong argument can be made for "insourcing" or "reshoring" work that was previously sent overseas to China. BCG estimates that between 10 percent and 30 percent of what America previously imported from China could very well be produced domestically by 2020. The expected dollar value of this increased output could be anywhere from $20 to $55 billion a year.

There are already signs that this transformation is well under way and should only continue, according to the consultancy the Hackett Group. And while the number of firms who have actually "reshored" their manufacturing operations to America is less than 100 so far, Hackett's research shows that 46 percent of executives at European and North American companies were considering bringing back a portion of their production to the US from China, with another 27 percent saying they were in the planning process of making such a move.

The main reason why some companies have been able to increase their manufacturing operations despite using relatively expensive US labor is the fact that, on average, American workers are almost three times more productive than their Chinese counterparts.

Through the continuation of the above mentioned favorable trends, and in conjunction with concentrated and coordinated efforts on the part of government,

industry and higher education, it is believed that manufacturing in the U.S. can be revitalized. This would provide much needed innovation, while at the same expanding the manufacturing base and hopefully creating more-high paying jobs.

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