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The Truth about American Manufacturing

By John Manzella
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When asked to describe the state of American manufacturing, many say it has been "hollowed out." When asked why, they point to the decline in manufacturing jobs, note the few "Made in America" products on retail store shelves, and identify importing and offshoring as the culprits. Although many of these reasons appear persuasive, they're not accurate.

U.S. manufacturing employment, no doubt, has declined from a high of 19.5 million workers in 1979 to approximately 12 million today. The primary reason, however, has everything to do with technology, innovation and automation, which have empowered fewer employees to produce much more in less time. In turn, "productivity in the manufacturing sector has been growing both absolutely and relative to other sectors of the U.S. economy," say Theodore Moran and Lindsay Oldenski of the Peterson Institute for International Economics."

Another factor impacting the decline in manufacturing jobs is this: depending on the specific sector, "30 to 55 percent of manufacturing jobs in advanced economies are in service-type functions," McKinsey Global Institute reports. As manufacturers continue to focus on their core competencies and contract various functions to suppliers, many of these service-related jobs, like research and development, marketing, design, sales, accounting and payroll, and packaging, are shifted to local accounting, marketing, payroll, and other highly specialized service firms that offer greater value. In turn, government statistics would indicate a decline in manufacturing jobs and an increase in the service sector.

Surprising to many, manufacturing value-added output has not decreased. In fact, with the exception of recessionary periods, it has risen each year, jumping from $545 billion in 1979 to nearly $2.1 trillion in 2013, the Bureau of Economic Analysis reports. And what is occurring in the manufacturing sector already has occurred in the agricultural sector. According to the Bureau of Labor Statistics, in 1940, 9.5 million U.S. workers were employed on farms, but by 2013, this number had declined to approximately 2 million. Yet, U.S. agricultural output skyrocketed.

When walking down the isles of many retail stores, few products carry the "Made in America" label. There's a good reason. Today, an increasing number of American manufacturers produce high margin, higher technology products that incorporate significant levels of intellectual property, such as medical equipment, pharmaceuticals, aerospace equipment, and computer chips, and no longer focus on consumer goods to the extent they did in the past. In turn, many consumer products are imported.

Numerous Americans believe imports are bad for the economy for various reasons. One involves the negative impact of imports on gross domestic product (GDP). Thus, last year U.S. GDP was nearly $16.8 trillion, according to the Bureau of Economic Analysis. One of the main line items, Net Exports of Goods and Services or the difference between exports and imports, was nearly -$500 billion. As a result, many draw the conclusion that imports are damaging to the economy. In reality, it's not that simple.

Imports offer American consumers greater choices, a wider range of quality, and access to lower-cost goods and services. They also create competition, forcing domestic producers to improve value by increasing quality and/or by reducing costs. Plus, since imports like inexpensive clothing allow the American family to purchase more goods for less money, stretching the dollar, more disposable income is available for other things, such as education, health care and mortgage payments. Imports also help keep inflation down, which is one of the most important factors in raising our standard of living. And since more than half of all U.S. imports are intermediate inputs used in the final production of U.S. products, they also help U.S. manufacturers remain globally competitive.

Of course, attractive imports that compete directly with U.S.-produced products do cause U.S. job dislocations. But surprising to many, the number is much smaller than generally assumed. And even more surprising is the number of U.S. jobs created from imports. Research by the Heritage Foundation, a Washington, D.C.-based think tank, cites "the increased economic activity associated with every stage of the import process helps support American jobs. A lot of them."

For example, the Heritage Foundation says over half a million jobs are supported by imports of Chinese-made clothes and toys alone. "These are jobs in fields such as transportation, wholesale, retail, construction, and finance, and in a myriad of other activities that are involved in turning a manufactured product into a good that is ready for use by the average American."

Surprising to many, when U.S. companies decide to invest abroad, labor cost is only one of many factors considered. Other factors, which often are more important, include the availability of skilled workers, productivity levels, the quality of local infrastructure, political stability, rule of law, proximity to key markets, and ability to repatriate profits.

That's why the United States, which does not offer cheap labor, remains the top destination of the world's foreign investment. Stated by Daniel Ikenson, Director of The Cato Institute's Herbert A. Stiefel Center for Trade Policy Studies, "As of 2013, nearly $1 trillion of foreign direct investment was parked in U.S. manufacturing, by far the number-one manufacturing investment destination world-wide. Clearly, the most successful foreign-headquartered companies see a future for U.S. manufacturing."

When U.S. manufacturers invest or produce abroad, the impact on the United States also is very different than public opinion might reveal. Hence, "foreign expansion of U.S. manufacturing multinationals has helped to strengthen, rather than weaken the U.S. manufacturing base even though it employs fewer workers," Theodore Moran and Lindsay Oldenski claim. This conclusion is based on data from U.S. manufacturing multinationals over a 20-year time period. The bottom line: "U.S. multinationals that increase their investments abroad simultaneously increase the size and strength of their manufacturing activities in the U.S."

For example, a U.S.-based manufacturer may establish a production facility in China to support its expanding Chinese business. In turn, the U.S. affiliate likely will import various components from its U.S.-based facility, as well as its deep intellectual property: creations of the mind that are incorporated into the objects. In turn, the U.S.-based facility benefits.

When U.S. firms establish manufacturing facilities abroad, some plants in the United States may close as others open. However, Theodore Moran and Lindsay Oldenski's data shows that the creation of jobs and the increase of sales abroad by U.S. multinationals are both associated "with more jobs at home overall." And their statistics are impressive.

For example, a 10 percent increase in employment at a foreign manufacturing affiliate is associated with an increase in its U.S.–based operation of 6.2 percent in R&D spending, 3.9 percent in sales, 3.8 percent in employment, and 3.8 percent in exports. Similarly, a 10 percent increase in sales at a foreign manufacturing affiliate is associated with an increase in its U.S.–based operation of 8.2 percent in R&D spending, 2.5 percent in sales, 2.2 percent in employment, and 2.6 percent in exports. And this does not include the increases experienced by U.S.-based service firms associated with the foreign based operation.

The misperceptions and myths surrounding the American manufacturing industry, no doubt, continue to perpetuate. Nevertheless, the reality is quite different.