Growth STRATEGIES

Trend Analysis That Builds Business Decisions

LA JOLLA INSTITUTE

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1 – INTRODUCTION

Manufacturing employment has fallen below 12 million jobs for the first time since 1941, and manufacturing jobs as a percentage of total employment has fallen below 9%, the lowest level since the Bureau of Labor Statistics started collecting data in 1939. But annual manufacturing output per worker is also at a record high: $223,915 (in constant 2000 dollars). That's almost 3 times as much output per worker as in the early 1970s, and twice as much output per worker compared to the mid-1980s.

That has been the trend over the last 40 years: more output with fewer workers. That's a good thing, isn't it? Let's take a look from a couple of different perspectives.

2 – REVERSING INDUSTRIAL DECLINE

After dominating global industrial activity for a century, the United States is losing its edge in manufacturing to other nations. Over the last 30 years, manufacturing has fallen from a quarter to an eighth of the domestic economy, while the share of manufactured goods consumed in America but produced by foreigners has risen from a tenth to a third. The decline of US manufacturing is reflected in record merchandise trade deficits, the loss of over 40,000 manufacturing jobs every month in the current decade, and the shrinking role of American producers in global industries such as electronics, steel, autos, chemicals and shipbuilding.

So finds the Lexington Institute in a recent report.

US manufacturers continue to generate over 20% of global industrial output and have increased productivity by a third in this decade, but if current trends continue America will cease to be the biggest manufacturing nation in the near future. Many factors have contributed to the slippage in US standing, including high corporate taxes, burdensome regulations, globalization of the economy, and the efforts of trading partners to protect their economies.

If the erosion of US manufacturing persists, America will become more dependent on offshore sources of goods and the nation's trade balance will weaken. That will undercut the role of the dollar as a reserve currency and diminish US influence around the world. Lexington concludes, "The economy will be less capable of supporting major military campaigns and less resilient in the face of market reverses. Most profoundly, America will become poorer relative to other nations, a trend that the National Intelligence Council says is already under way in its most recent assessment of global trends."

3 – CHINA GAINS IN MANUFACTURING

China is on its way to surpassing the US as the world's largest manufacturer far sooner than expected. Does that matter? In terms of actual size, the answer is no. But if size is a proxy for relative health of each nation's sector, writes Timothy Aeppel in the Wall Street Journal, the answer is yes.

The US remains the world's largest manufactuer. In 2007, the latest year for which data are available, the US accounted for 20% of global manufacturing; China's share was 12%. The gap, though, is closing rapidly. According to IHS/Global Insight, China will produce more in terms of real value-added by 2015.

US manufacturing is shrinking, shedding jobs and, in the wake of this deep recession, producing and exporting far fewer goods, while China's factories keep expanding. Given the massive trade gap between the two nations and uncertainty in the US over when and to what degree manufacturing will recover, writes Aeppel, China's ascent has become a point of growing friction.

Many economists argue that the shrinking of US manufacturing – both in terms of jobs and share of gross domestic product – is a normal economic evolution that started long before China emerged as a manufacturing powerhouse. From their point of view, explains the author, the shrinking would happen regardless and is actually a sign of health that the sector doesn't need to be big to be productive and is shedding low-skill jobs and creating select higher-skill ones.

To those who view China's rise as normal, or even healthy (see our next item), it is the natural course of things for national economies to progress along the continuum from agriculture to manufacturing to services. We have trod that path, and now China is following. This is beneficial as long as there is free trade, in this view.

But another school of thought, held by "manufacturing fundamentalists" (see our last item) contends that US decline is not natural, not beneficial, and must be reversed to retain America's economic power and well-being. From this perspective, the idea that we can be a nonmanufacturing society – and still be rich, free and independent – is nonsense and folly. Such thinking has lead, and will lead, to the collapse of civilizations.

Even in its weakened state, manufacturing remains a surprisingly large part of the US economy, Aeppel reminds us. The sector generates more than 13% of the nation's GDP, making it a bigger contributor to the economy than retail trade, finance or the health-care industry. Thus it would be devastating if US manufacturers now being hit by the economic downtown never recover.

4 – MANUFACTURING NOT IN DECLINE

Real US manufacturing output has increased by 81% since 1987. American real manufacturing value-added – the market value of manufactured goods, over and above the costs that went into their production – reached a record-high level in 2007. Notwithstanding the recent recession that has affected all sectors of the economy, US manufacturing has been thriving in recent years. So contends Daniel Ikenson of the Cato Institute.

Manufacturing as a share of gross domestic product peaked in 1953 at about 28% of the economy and has been trending downward ever since. Today manufacturing accounts for about 12% of our services-dominated economy, but manufacturing output and value-added are higher than ever in real terms.

According to the United Nations Industrial Development Organization, US factories are the world's most productive, accounting for 25% of global manufacturing value-added. By comparison, Chinese factories account for 10.6%.

That may be hard to fathom, writes Ikenson, given that US factories tend not to produce the sporting goods, toys, tools, and clothing found in Wal-Mart and other retail outlets nowadays. But US factories make pharmaceuticals, chemicals, technical textiles, sophisticated components, airplane parts, and other products. American factories have moved up the value chain.

The percentage of Chinese value-added in high-tech exports is quite small. Economists at the US International Trade Commission estimate that only about 50% of the value of US imports from China is actually Chinese value-added; the rest is value added in other countries and embedded in the components, design, engineering, and labor.

In iPods, for example, the Chinese value-added is a few dollars on a product that costs $150 to produce and retails for $299. Further, their sale in the United States and elsewhere supports high-paying American engineering, marketing, and logistics jobs, while providing Apple with the profits to conduct R&D to employ more engineers and keep the virtuous circle going. Without complementary Chinese and other foreign labor, far fewer American manufacturing ideas would come to fruition.

American manufacturing is by no means in decline, concludes Cato.

5 – THE PLIGHT OF AMERICAN MANUFACTURING

Yes it is, and therefore so is America, writes Richard McCormack, editor of *Manufacturing A Better Future for America*. He writes in Chapter One:

Long before the collapse of the US investment banking system in late 2008, once-dominant and important US industries like semiconductors, machine tools, printed circuit boards, consumer electronics, auto parts, appliances, furniture, clothing, telecommunications equipment, home furnishing and many others suffered their own economic collapse, sputtering anemically in a global economic system that continues to be stacked against US-based producers.

Many of the executives in these industries along with their workers have raised alarms, issued reports, testified before Congress and held press conferences about the plight of their US manufacturing assets and the potential for widespread economic adversity. They warned repeatedly that without industry generating good jobs, wealth and the funding needed for research and development, that the United States risked an economic collapse. The federal government ignored them at every turn, and it did so at its peril.

With a severely weakened industrial base – one of the only sectors of the economy that creates wealth – the US financial system suffered a historic meltdown. With the US government plunging deeper into debt by trillions of dollars, it now becomes imperative for the United States to ensure that the industrial sector regains its strength and that the nation becomes an exporting juggernaut. In order to avert a slide into economic depression, the United States will have to stop going deeper into debt to pay off its bad debts. The country must restart its industrial engine and produce products that Americans need to buy and the world demands. If this does not happen, a federal government bankruptcy could dwarf the financial industry collapse of 2008. The solution to the problem no longer entails Americans to "go shopping more."

Free trade economists, retailers, Wall Street mavericks who relentlessly pressured companies to move their production offshore to make a few more pennies per share, shipping companies, foreign producers, foreign countries, newspapers dependent on retailers for their ad revenue, multinational companies and all of their lawyers, lobbyists and think tanks in Washington, and most members of Congress supported by all of these interests have been in control of the economic agenda for the past 30 years. They have successfully argued that it is not necessary for the United States to maintain a strong, vibrant industrial base, because it is cheaper to buy goods from developing countries that have distinct economic advantages.

The collective denial by America's economic elite of the need for an industrial base has led the country to a precipice. Domestic manufacturers and producers have grown increasingly frustrated with economists who for decades have rationalized manufacturing job losses as being good for the economy. Manufacturers argue that the federal agencies, the administration and Congress – Republicans and Democrats alike – have been negligent in their stewardship of the economy. The United States is not generating enough wealth to pay its mounting and massive debts. Cheap imports made in unsafe, low-wage factories overseas are not improving the fortunes of America's least fortunate, much less its middle class. The US trade deficit in 2008 stood at $700 billion – or about $2,000 for every American. That is $8,000 for a family of four, far greater than the $2,000 in savings importers and retailers claim a family saves from the lower costs of imported products. And the $8,000 per year debt does not include the interest that must be paid over the long run.

- Without a healthy industrial base, workers are no longer making a livable wage needed to maintain payments on assets like homes and they cannot afford basic necessities like energy, food, education and health care.
- Without an industrial base, an increase in consumer demand, which historically pulled the country out of recession, will not put Americans back to work. Any additional consumer spending will only help workers making products overseas. This represents a fundamental break from previous recessions and has led many in the manufacturing sector to fear the growing likelihood of a sustained downturn.
- Without an industrial base, the country ran out of money to fix an infrastructure that was rapidly deteriorating, with bridges and levies falling to the mighty Mississippi River.
- Without an industrial base, major American cities like Detroit and New Orleans lay in ruins.
- Without an industrial base, California's economy has gone bust. Literally thousands of other American communities have lost their local factories and are decrepit.
- Without an industrial base, it was only a matter of time before the contagion in manufacturing hit the financial, construction, housing and retail sectors. At some point, the contagion will reach the country's largest employers: state, local and federal governments.

The United States is broke. It is broke because it has stopped producing what it consumes. Those who work in the US manufacturing sector – those who own companies that produce goods – know that without Americans making products, there will not be enough wealth to support the retirement and staggering health costs of the largest generation in the history of the nation.

6 – CONCLUSION

Our introduction made a statement and posed a question. We stated that the trend over the last 40 years has been more output with fewer workers. We asked if that was a good thing. Our answer: yes, as long as we retain an industrial base.