

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-6515

To: Members, Subcommittee on Economic Growth, Tax and Capital Access
From: Committee Staff
Date: March 10, 2014
RE: Made in the U.S.A.: Small Businesses and a New Domestic Manufacturing Renaissance

On Thursday, March 13, 2014 at 1:00 p.m., the Subcommittee on Economic Growth, Tax and Capital Access of the Committee on Small Business will meet in Room 2360 Rayburn House Office Building for a hearing titled: "Made in the U.S.A.: Small Businesses and a New Domestic Manufacturing Renaissance." The hearing will examine the return of manufacturing activity to the United States that had largely been taking place overseas, a trend some refer to as "re-shoring," and what the potential economic implications of this trend mean for small businesses.

I. Manufacturing and the United States Economy

The manufacturing sector of the United States economy generates a great deal of interest and attention on the part of policymakers and other stakeholders. According to the World Bank, manufacturing value-added contributes more than 12 percent of total United States Gross Domestic Product.¹ Despite an aggregate decline in manufacturing employment, approximately 9 percent of working Americans are employed at manufacturing firms.² Of these firms, more than 98 percent likely meet the United States Small Business Administration's definition of a small business.³

Opinions on the economic health of manufacturing appear split between those holding a relatively pessimistic view on the economic health of manufacturing and those with a more positive view. Those who are more pessimistic are alarmed by long-term aggregate declines in manufacturing employment and the changing composition of manufacturing output. Since peaking at 19.6 million jobs in 1979, total employment in manufacturing has declined to 12.05 million jobs according to recent federal government statistics.⁴ These declines in manufacturing employment are seen as troublesome for workers and the economy as a whole. This view also largely attributes declines in manufacturing jobs and output to trade competition, rather than other factors, such as improvements in worker productivity.⁵

¹ <http://www.tradingeconomics.com/united-states/manufacturing-value-added-percent-of-gdp-wb-data.html>.

² <http://www.bls.gov/iag/tgs/iag31-33.htm>.

³ UNITED STATES SMALL BUSINESS ADMINISTRATION, TABLE OF SMALL BUSINESS SIZE STANDARDS, available at http://www.sba.gov/sites/default/files/files/size_table_01222014.pdf.

⁴ http://www2.census.gov/econ/susb/data/2010/us_6digitnaics_2010.xls.

⁵ ROBERT D. ATKINSON, LUKE STEWART, SCOTT ANDES AND STEPHEN EZELL, THE INFORMATION TECHNOLOGY & INNOVATION FOUNDATION, WORSE THAN THE GREAT DEPRESSION: WHAT EXPERTS ARE MISSING ABOUT AMERICAN MANUFACTURING DECLINE 3 (March 2012) [hereinafter "ITIF Report"], available at <http://www2.itif.org/2012-american-manufacturing-decline.pdf>.

Those that espouse a more optimistic view believe changes taking place in the manufacturing sector of the economy, especially the shifting composition of manufacturing output, are a positive sign of the United States economy's resilience and comparative advantage in advanced technology. This view sees the decline in total manufacturing employment as a function of improvements in productivity as firms are able to achieve higher rates of manufacturing output with fewer workers.⁶ This view also holds that the true measure of the relative health of domestic manufacturing is its value added output, which has increased even as total manufacturing jobs have declined.⁷ Many who hold this view also contend that any manufacturing jobs lost to trade competition are the result of each nation trading according to its comparative advantage, which results in benefits for each nation.

Both views are based in some fact. However, shifts are taking place in the global economy that suggest a resurgence of manufacturing in the United States that may reverse job loss in this sector. These shifts and how they may affect small businesses and the United States economy are discussed below.

II. Global Economic Shifts

Over the last decade, a number of changes have occurred in the United States' economy and the economies of many of its trading partners that in combination appear to be improving the competitiveness of manufacturing in the United States.⁸ A description of some of these factors, and how they may positively influence the manufacturing sector of the economy, is briefly discussed below.

A. Narrowing of productivity-adjusted wage differentials between the United States and other key manufacturing economies

Lower cost wages are a key factor in the decision by some firms to source manufacturing in certain overseas countries, predominately China, rather than the United States. However, over the last several years, worker wages abroad have been rising and are forecast to rise faster than worker productivity in the economies of many of the United States' trading partners.⁹ According to one study, in 2000, the labor content of a typical auto component was 2.85 times more expensive in the United States compared to China. However, by 2015 the labor cost of the same product will be only 1.65 times more expensive to manufacture in the United States, thus reducing the cost advantage of manufacturing in China.¹⁰ Another report estimated that the overall wage gap between manufacturing in the United States and China will

⁶ Robert Samuelson, *Myths of Post-Industrial America*, THE WASHINGTON POST, April 8, 2013.

⁷ *Id.*

⁸ SHIRLEY E. MILLS, THE BOSTON COMPANY, POTENTIAL BENEFICIARIES OF A U.S. MANUFACTURING Renaissance 1 (May 2012) [hereinafter "Mills Report"], available at http://www.thebostoncompany.com/assets/pdf/views-insights/May12_Views_Insights_Potential_Beneficiaries_US_Manufacturing_Renaissance.pdf.

⁹ *Id.* at 3.

¹⁰ *Id.*

decline to \$7 per hour by 2015.¹¹ Similarly, higher relative wages paid in certain western European countries are improving the cost competitiveness of manufacturing in the United States.¹²

B. The depreciation of the United States dollar vis-à-vis the currencies of its major trading partners

The relative value of currencies can greatly influence trade flows. Holding all else constant, the lower the value of a nation's currency vis-à-vis the currency of another nation, the lower the price of its exports to the other nation. In recent years, the United States dollar has declined in value compared to the currencies of many of its trading partners, including the Chinese renminbi and the euro.¹³ Thus, United States exports to nations utilizing these currencies are cheaper while these nations' exports to the United States are more expensive.

C. Higher freight transportation costs and other supply chain disruptions

Higher global oil prices have led to an increase in the cost of shipping goods via ship, rail, and truck. In addition, the time cargo spends waiting to be offloaded from ships or cleared by customs has increased in recent years.¹⁴ The increased cost and time lags associated with shipping goods across vast ocean distances are causing some firms to choose to source more of their manufacturing closer to their customers.¹⁵ In addition, firms that are closer to their customers can better manage just-in-time inventories, reducing warehousing costs.

D. The emergence of the United States shale gas production boom and the resulting declines in United States natural gas prices.

As the Committee examined in a previous hearing,¹⁶ natural gas prices in the United States have fallen significantly in the last few years compared to prices paid in many trade competitors' economies. This trend is largely attributed to the development of domestic unconventional shale gas deposits. The reduced cost of natural gas has resulted in reductions in utility costs for manufacturers, further incentivizing firms to manufacture in the United States.¹⁷ According to one study, lower cost natural gas in the United States is forecast to improve domestic industrial production by between 2.9 percent to 4.7 percent and lead to an additional 1 million new jobs in manufacturing.¹⁸

¹¹ EULER HERMES ECONOMIC RESEARCH DEPARTMENT, THE REINDUSTRIALIZATION OF THE UNITED STATES 17 (2013), available at <http://www.eulerhermes.us/reindustrialization.pdf>.

¹² Mills Report, *supra* note 8, at 3.

¹³ HAROLD SIRKIN, MICHAEL ZINSER, AND DOUGLAS HOHNER, THE BOSTON CONSULTING GROUP, MADE IN AMERICA, AGAIN: WHY MANUFACTURING WILL RETURN TO THE U.S. 7 (August 2011) [hereinafter "BCG Restoring Study"], available at <http://www.bcg.com/documents/file84471.pdf>.

¹⁴ Mills Report, *supra* note 8, at 4.

¹⁵ *Id.*

¹⁶ *The New Domestic Energy Paradigm: Potential Benefits for Small Businesses and the United States Economy: Hearing Before the Subcomm. on Contracting and Workforce of the H. Comm. on Small Business*, 113th Cong. (2013).

¹⁷ In addition, natural gas serves as a feedstock in the manufacture of certain products, particularly chemicals and fertilizers.

¹⁸ CITIGPS, ENERGY 2020: NORTH AMERICA, THE NEW MIDDLE EAST? 10 (March 20, 2012), available at <https://ir.citi.com/%2FSyMM9ffgfOZguStaGpnCw5NhPkvdMbbn02HMA05ZX%2BJHjYVS07GqhxF2wMk%2Bh4tv7DEZ5FymVM%3D>.

E. Other factors influencing manufacturing decisions

In addition to the above-mentioned factors, some production managers have discovered that there are costs to manufacturing overseas that are more difficult to quantify on a balance sheet, but nonetheless reduce or negate the cost advantage of manufacturing in lower wage countries. These include, but are not limited to: intellectual property theft and quality control problems in foreign factories.¹⁹

However, while the combination of these factors has improved the United States' competitiveness in manufacturing, the re-shoring of manufacturing production to the United States is expected to vary from industry to industry. According to some economists, manufacturing growth in the United States is expected to be concentrated in those industries where labor costs represent a small fraction of manufacturing costs or in sectors where the productivity of United States workers reduces or negates the cost benefits of lower-wage, but less productive, foreign workers.²⁰ For example, labor represents only 25 percent of the cost of manufacturing certain auto parts. Thus, when the higher productivity of American workers is taken into account and combined with the other factors mentioned earlier in this memorandum, the cost advantage in manufacturing in a lower wage nation, like China, shrinks significantly.²¹

III. **Manufacturing Re-shoring and Its Benefits for Small Business and the United States Economy**

Small businesses are expected to benefit from a manufacturing re-shoring trend by providing components and other supplies and services to a re-shored product's original equipment manufacturer.²² An April 2012 poll of 259 American manufacturers indicated that 40 percent benefited in some way from manufacturing work previously done abroad.²³

The transportation of domestically manufactured components and assembled products could create additional economic opportunities for small businesses in the transportation sector.²⁴ As approximately 97 percent of commercial motor vehicle carriers meet the United States Small Business Administration definition of small businesses, many of these new economic opportunities could accrue to small businesses.²⁵

¹⁹ Charles Fishman, *The Insourcing Boom*, THE ATLANTIC (December 2012).

²⁰ HAROLD SIRKIN, MICHAEL ZINSER, DOUGLAS HOHNER AND JUSTIN ROSE, THE BOSTON CONSULTING GROUP, U.S. MANUFACTURING NEARS THE TIPPING POINT: WHICH INDUSTRIES, WHY AND HOW MUCH? (March 22, 2012), available at https://www.bcgperspectives.com/content/articles/manufacturing_supply_chain_management_us_manufacturing_nears_the_tipping_point/?chapter=5#chapter5.

²¹ BCG Re-shoring Study, *supra* note 13 at 10. For other manufactured goods, the cost of labor may only represent less than 10 percent of the cost of producing the good. See also Mills Report, *supra* note 8, at 3.

²² Mills Report, *supra* note 8, at 6.

²³ <http://reshorennow.org/news/pressrelease.cfm?pid=3>.

²⁴ Mills Report, *supra* note 8, at 6.

²⁵ The Small Business Administration defines a trucking firm as small if it earns less than \$25.5 million in gross revenue. 13 C.F.R. § 12.201. For purposes of previous rulemaking, the Federal Motor Carrier Safety Administration estimates the average small business trucking firm would have fewer than 141 trucks. Hours of Service of Drivers, Final Rule, 76 Fed. Reg. 81,134 (December 27, 2011).

The trend in manufacturing re-shoring will also lead to an increase in total employment in this sector. Since the technical end of the latest economic recession, the economy has created approximately 320,000 new manufacturing jobs.²⁶ According to one estimate, the re-shoring of manufacturing production from China alone will result in the creation of between 600,000 to 1 million direct manufacturing jobs.²⁷ In turn, these new jobs would help facilitate the indirect and induced creation of an additional 1.8 million to 2.8 million new jobs in industries heavily represented by small businesses, such as: construction, retail, transportation, food services and housing.²⁸ According to some economists, the job creating multiplier effect in manufacturing is generally higher than that associated with the service sector.²⁹

IV. Factors that Could Reverse or Limit the Re-shoring Trend

The current trend in manufacturing re-shoring, and its concomitant benefits to small businesses and the economy, is not guaranteed. Some of the factors that have helped make manufacturing in the United States more competitive are reversible if poor domestic policy choices are enacted, such as new regulations on energy that increase its cost to domestic manufacturers. Other challenges include needed reforms to the nation's corporate tax rate, which in many cases is higher than its competitors. In addition, as manufacturing processes become more advanced, small manufacturers will need access to workers with higher level knowledge and skill sets to operate and understand the more complex machinery and processes associated with modern manufacturing.

V. Conclusion

Recent business surveys and press reports indicate a revival in domestic manufacturing in the United States. Small businesses stand to benefit as manufacturers themselves, and as key players in the supply chains that support larger manufacturers. Growth in manufacturing activity in the United States translates into job creation supported by small firms.

At the same time, some of the factors influencing the current re-shoring trend and improving the competitiveness of United States manufacturing are reversible. Therefore, policymakers should take into consideration the full scope of factors influencing the competitiveness of domestic manufacturing before the imposition of policies that would generally reduce this sector's trade competitiveness.

²⁶ <http://data.bls.gov/timeseries/CES3000000001> (last visited March 6, 2014). It should be noted that while the recession technically ended in June 2009, manufacturing employment continued to decline until July 2011 and is still 1.7 million jobs lower than its pre-recession level. *Id.*

²⁷ Mills Report, *supra* note 8, at 6. Please note, these would be in addition to the 1 million new manufacturing jobs associated with shale gas production mentioned earlier in the memorandum.

²⁸ *Id.*

²⁹ ITIF Report, *supra* note 5, at 20.