Reshoring Manufacturing in the Time of Trump – The Potential Disaster in Ethnocentrism and Trade Barriers

"This is not your grandfather's manufacturing"

Donald Trump may have won the U.S. Presidential election on the theme of "jobs, jobs, jobs," but his actions and policies are not going to create or bring back many new jobs for Americans. The reality is very different from the rhetoric.

Returning manufacturing to anywhere in the U.S. is likely to provide opportunities for manufacturers to modernize and automate production, thereby reducing operating costs and enhancing productivity and ultimately, requiring far fewer workers. Today's manufacturing jobs require a host of new skills and technology, and workers will have to be retrained to fit the skills required for new kinds of jobs such as running sophisticated machine tools, 3D printers, and robots. These jobs will provide higher pay for workers, but fewer worker jobs.

This is not your grandfather's manufacturing and it is not the low-cost manufacturing environment of China, Vietnam, Bangladesh, Indonesia, or Mexico.

Much has changed in the 20 years since companies started offshoring to take advantage of low-cost production environments. The jobs needed in American advanced manufacturing today are fewer and very different than they were when companies headed south to Mexico and west to China in the 1990s and 2000s. What Mr. Trump has failed to understand is that these low-wage, low-skilled jobs are never coming back. In fact, although Mr. Trump made many promises during his presidential campaign, almost nothing has been realized so far.

- Of particular importance to global manufacturing businesses is the potential for trade and tariff policy changes that will grossly affect profit margins.
- New tariff barriers are likely to cause global trade wars and perhaps a global recession.
- Potentially exiting the North American Free Trade Agreement (NAFTA) is likely to have an enormous negative economic impact.
- Eliminating or restricting the H1B visa program will cripple innovation and software development.

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EXITING THE TPP

One of Mr. Trump's first actions was to withdraw from the Trans-Pacific Partnership (TPP)[I]. The TPP is an ambitious regional trade agreement comprising 12 countries – Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Singapore, Peru, Vietnam and the United States – that accounts for around 40% of world GDP. The agreement was intended to institutionalize common rules for trade and business. This withdrawal has far-reaching implications for geopolitics in the Asia-Pacific region where economic growth rates are 3-4 times the industrialized west and can be as high as 8% in some sectors.[II]

The development of this agreement happened over 10 years, was signed by members in 2016 but it needed to be ratified by at least six countries accounting for 85% of the total GDP of the entire block, before it could be implemented. Without ratification by the U.S., this cannot happen.

The likelihood of a renewed agreement that includes China amongst the remaining nations is high and will dramatically change the U.S.' stature and influence in the Pacific.

Mr. Trump prefers to deal bilaterally rather than in a regional framework. He claims that bilateral negotiations give more power to the U.S. to protect American industries and workers. His ethnocentric approach to what he calls "Putting America First" is very short-term thinking that may cause rising tariff barriers in other countries, where U.S. exporters are harmed and U.S. consumers wind up paying more for goods.

ANOTHER SMOOT-HAWLEY?

The Trump Administration argues that instead of doing nothing, we should take every opportunity to raise all import tariffs, eliminate trade agreements, and close U.S. borders to immigrants and trade. This he says, will make America competitive, even though there is no gain in productivity, efficiency, or cost reduction in American manufacturing.

What the Trump Administration is forgetting is that America has gone down this pathway before with the Smoot-Hawley Tariff Act of 1930, which raised tariffs on about 900 products.[III] Historians blame Smoot-Hawley for triggering the Great Depression of the 1930s. They point out that Smoot-Hawley caused sharp increases in consumer prices, which led to consumers buying fewer products, which in turn led to low demand, layoffs, high unemployment and ultimately the stock market crash. Although it originated in the United States, the Great Depression caused drastic declines in output, severe unemployment, and remarkable deflation in almost every country of the world.

Leaders of Trans-Pacific Partnership members at a meeting in 2015. Jonathan Ernst/Reuters

THE NAFTA TREATY

The North American Free Trade Agreement, or NAFTA, is a trading block treaty negotiated by the governments of Canada, Mexico, and the United States that entered into force in January 1994.[IV] NAFTA essentially eliminated nearly all tariffs among the three signatory nations, allowing for the flow of goods and supplies across borders without taxes or tariffs. Today, approximately $1.4 billion in goods crosses the U.S.-Mexico border every day and $1.6 billion crosses the U.S.-Canada border.

If the NAFTA treaty is rescinded, as Trump has indicated he wants to do, the U.S. would be free to increase tariff rates on imports, presumably to make manufacturing in the U.S. seem more cost competitive. But import tariffs only mask the true problem and allow companies to get lazy about becoming cost-efficient and more productive. Instead of focusing on productivity improvements and cost cutting, manufacturers would not have to do much of anything different to compete with tariff-laden, higher-priced imports. Prices are likely to increase across the board on imports of raw materials, subassemblies and consumer goods. As a result, U.S. consumers will have to pay more for imported goods on par with American-made goods. The consumer loses both ways.

THE REPUBLICAN LEADERSHIP IN CONGRESS PROPOSES A BORDER ADJUSTMENT TAX

The Republican leadership in Congress has proposed a Border Adjustment Tax (BAT) that would place new taxes on all imports to the U.S. and provide tax relief for exports. If the proposed Border Adjustment Tax is imposed, our trading partner countries are likely to raise tariffs on imports coming into their countries. Take fruits and vegetables for example. More than 6 billion pounds of fruits and vegetables were imported from Mexico in 2015-2016. Mexico provides 70% of fresh fruits and vegetables consumed in the U.S. Corn and soybeans from American farms move the other direction into Mexico. If a tariff is placed on fruits and vegetables from Mexico, and Mexico retaliates with a tariff of their own, American consumers will suffer higher prices, and American farmers will find it harder to compete for business in Mexico.

Electronics imports are also likely to cause increased consumer prices. Today, the majority of electronic products and electronic component parts come from Asia, primarily China. Because there is little in the way of competing business in the U.S., tariffs on electronics imports are very low or zero. Applying a BAT on electronics, consumers will have pay more. Since there is little competing industry in the U.S., the benefits to American business will be negligible.

TRADE WARS

Another concern is the likelihood of a trade war with Mexico and other countries.

But it is not always tit-for-tat when it comes to trade wars. When the U.S. places additional tariffs on imported products, our trading partner countries may apply an import tariff on a completely different product. For example, the U.S. may apply countervailing duty to solar panels from China, and China responds by placing additional duty on imported farm products, hurting American farmers.

Since Border Adjustment Tax would apply to all U.S. imports, BAT would likely cause trade wars around the world, with countries retaliating as they see fit. It's unlikely that any country would stay silent on this issue and would instead apply retaliatory import taxes to American exports. This is likely to cause economic harm to U.S. exporters and inflationary prices for U.S. consumers.[V]

H1B WORK VISAS

Another Trump campaign promise was to eliminate the H1B visa program that allows companies to temporarily hire foreign workers in specialty occupations including fields like science, engineering, and information technology. These visa holders are usually required to have highly specialized knowledge and a bachelor's degree or higher in the specialty or its equivalent. The visas are valid for three years at a time and can be renewed.

H1B visas are widely used in Silicon Valley, where the need for highly-skilled talent is relentless. According to Bloomberg[VI], these companies tend to pay H-1B visa workers $65,000 to $75,000 a year. Nearly 70% of all H-1B visas go to Indian workers with skills in computer software engineering.

Demand for the visas is so high, the visa award limit is reached within days of opening up the application window. Silicon Valley uses the majority of the visas and many companies are concerned that without the H1B program, the high-tech innovation economy will slow significantly.

WHAT'S NEXT?

A radical change to import tariffs, a renegotiation of NAFTA or outright withdrawal from the treaty, elimination of H1B visas, and the igniting of trade wars could cause much turbulence the U.S. economy. Trump's policies are unlikely to improve America's heartland and rustbelt manufacturing jobs that Trump has promised his voters he would bring back. In fact, the world operates in tightly interconnected global economies. Increased tariffs and trade barriers would likely end up causing more job losses around the world and a potentially disastrous global recession or depression.

Trump's administration appears to be tumultuous and crippled by conflict within the Republican Party and resistance by Democrats. His campaign promises are not being implemented which may, in the end, shield American consumers from increasing prices and economic disaster.

ABOUT THE AUTHOR

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ABOUT THE RESHORING INSTITUTE

Our Vision

In collaboration with USD's Supply Chain Management Institute, we are recognized as the premier research and support organization for companies considering reshoring their global sourcing and manufacturing. We do this through rigorous research, publishing, and the development of analytical tools.

Our Mission

The Reshoring Institute has a dual mission:

1. Provides research and support for companies bringing manufacturing back to America
2. Provide experiential education and opportunities for USD students to learn about global sourcing and manufacturing

https://www.ReshoringInstitute.org

[i] https://www.washingtonpost.com/business/economy/withdrawal-from-trans-pacific-partnership-shifts-us-role-in-world-economy/2017/01/23/05720df6-e1a6-11e6-a453-19ec4b3d09ba_story.html?utm_term=.bcb381057d39

[ii] https://www.adb.org/sites/default/files/publication/182221/ado2016.pdf

[iii] http://americastradepolicy.com/did-the-smoot-hawley-tariff-cause-the-great-depression/#.WP1orGe1v3g

[iv] https://en.wikipedia.org/wiki/North_American_Free_Trade_Agreement

[v] http://www.investopedia.com/terms/b/border-adjustment-tax.asp

[vi] https://www.bloomberg.com/graphics/2017-h1b-tech/