Reshoring: myth or reality?
By Zeeshan Haider

IBISWorld has conducted an analysis of the perceived causes of the reshoring movement and its implications for the US economy.

For decades, US companies in the manufacturing sector have increasingly sought to cut costs and improve profitability by offshoring and offshore outsourcing operations. Offshoring is the process in which companies base their operations overseas; offshore outsourcing is the process in which companies base part of their operations overseas and third-party companies are hired to perform operational duties.

However, recent analysis by independent sources suggests there has been some reversal in this trend over the past five years. As manufacturing makes its way back to the United States, a process known as reshoring, US-based manufacturers will have to determine the potential consequences and opportunities that can arise as a result of this movement.

The case for reshoring
China has been the most popular destination for offshoring by companies with advanced economies. However, manufacturing in China for the North American market has become cumbersome for many US manufacturers. This is especially true for small businesses that lack the capability and the resources to remain on top of their offshore operations.

These manufacturers also lack the ability to withstand losses due to lack of quality assurance, compliance and delivery; consequently, they have been growing increasingly weary of offshoring to China. Additionally, several other structural factors have increased the cost of doing business in China, further deterring US manufacturers from moving operations there.

Labor costs in China have been rising at an accelerated pace over the past several years. According to the National Bureau of Statistics of China, between 2009 and 2014, the average manufacturing wage in China increased at an annualized rate of 14.6%, from $3,962.50 to $7,831.90. In comparison, according to the latest data available from the Bureau of Labor Statistics, the average US manufacturing wage for workers in the private sector increased at an annualized rate of 2.4% over the five years to 2013 (latest available data).

IBISWorld estimates that over the five years to 2015, the average manufacturing wage in the United States will decline at an annualized rate of 0.4% to $62,562.10. Despite rapid growth in wages in China, the average wage in the United States remains approximately eight times higher. However, this gap is reduced significantly when factoring in higher...
productivity of the US workforce and greater access to greater automation and technology. Additionally, direct labor costs are not significant enough to most advanced manufacturing industries’ cost structures, further weakening the advantage of labor costs for China. Nonetheless, the overall gap in labor costs remains extremely significant; thus, rising labor costs are not the sole driving force behind the reshoring movement, presenting opportunities merely for very specific industries that produce high-value items and require vast amounts of skilled labor.

Additional factors that provide the impetus for reshoring include having greater control over the production process, reliability of domestically manufactured products, a higher degree of quality control and assurance and the prestige associated with a made-in-America product. This is especially important for industries that serve continuously changing markets, such as fashion and technology. For example, Boston Consulting Group (BCG) claims that once freight costs, transaction costs and other risks are taken fully into account, the advantage of producing in China for the North American market will decrease significantly and US-based production will become more preferable to serve the North American market.

Over the past five years, there has been little evidence to suggest that reshoring has resulted in any significant change in the US economy. While peripheral evidence indicates growth in manufacturing, a large-scale push toward reshoring has not been apparent over the past five years. Nonetheless, this movement could gain momentum over the next five years, as the Chinese economy changes further.

Data from the Bureau of Economic Analysis and the US Census Bureau, coupled with IBISWorld analysis, indicates that US exports of goods will increase at an annualized rate of 5.7% in the five years to 2015, representing a decrease from the annualized 8.8% increase between in the five years to 2014. Import growth has remained relatively subdued, resulting in an annualized increase in the US trade-balance over the five years to 2013. While some of this improvement in the trade-balance may be a result of import substitution fueling the reshoring movement, the effect of exchange rate dynamics must also be taken into consideration.

The trade-weighted index, which measures the value of the US-dollar compared with currencies of the United States’ main trading partners, declined
Reshoring: myth or reality?

every year between 2001 and 2009. After a temporary shock in 2009, when the index appreciated 4.3%, it declined further in 2010 and 2011. These years of declines resulted in significant changes in cost structures for US-based manufacturers and US-based companies that offshored their manufacturing operations. The decline in the value of the dollar restored the competitiveness of many US-based manufacturers in the international market, while simultaneously making imports more expensive for domestic consumers. Consequently, import substitution increased, further fueling reshoring.

However, since the rise of the trade-weighted index and the appreciation of the dollar, these trends are starting to show some reversal. For example, over the five years to 2013, the US trade balance in goods increased at an annualized rate of 3.4%, whereas over the five years to 2014, this reversed to a 7.6% annualized decline, trending closer to its precrisis value in 2007. IBISWorld anticipates that the US trade balance in goods will decline at an annualized rate of 4.0% over the five years to 2015. Furthermore, it proclaims that any analysis of the consequences of reshoring without taking into account the impact of current and future exchange rate dynamics will remain incomplete. Over the five years to 2020, IBISWorld expects the trade-weighted index to rise at an annualized rate of 4.0%, which could make US exports unattractive and may even reverse the current trend in import substitution by making low-cost imports an attractive proposition once again.

Consequences and opportunities

Despite the massive wage differential between the United States and some manufacturing hubs in Asia, a unique set of circumstances benefited some US-based manufacturing industries, and the enduring legacies of these changes are expected to continue to be beneficial over the next five years. One such sector that has benefited from the reshoring movement is the chemical sector. Other than the strict regulatory oversight that makes domestic production preferable, the availability of skilled labor at lower costs compared with the rest of the advanced economies, and a boom in oil and natural gas production has helped the chemical sector in the United States grow over the past five years. IBISWorld data indicates that in the five years to 2015, imports as a share of domestic demand are expected to decline for the Petrochemical, Inorganic Chemicals, Organic Chemicals and Pesticide Manufacturing industries. Increasing domestic demand across all these sectors and declining import penetration is indicative of the operators’ preference for domestic manufacturing. To that end, many large chemical conglomerates such as Monsanto Company, DuPont and Bayer AG are increasing their presence in the United States by making significant investments in their US-based manufacturing infrastructure. Imports as a share of domestic demand are expected to continue to decline for all of these industries over the five years to 2020, indicating a persistent preference for domestic production.

The apparel sector has also been an unlikely beneficiary of the reshoring movement. After years of offshoring and outsourcing, many companies are bringing back production to the United States. However, companies that target niche markets and high-income individuals are likely to benefit most from this trend. Demand for apparel is income- and price-elastic; however, its price-elasticity decreases as income increases, indicating that high-income individuals typically do not make their clothing purchases based on price but rather on prestige,
Reshoring: myth or reality?

Brooks Brothers, an important player in the Men’s and Boys’ Apparel Manufacturing industry has reshored almost 70.0% of its manufacturing operations to the United States, and Philip Van Heusen has restarted manufacturing Calvin Klein shirts in the United States after several decades. One of the main challenges faced by apparel manufacturers is the high cost of labor and lack of skilled labor needed for high-end apparel manufacturing. After years of offshoring, the United States has lost its stock of skilled workers for this industry and many operators are having trouble filling jobs. Consequently, brands and manufacturers that can target high-income consumers and have large margins on their products are the ones that are likely to benefit from reshoring. Production of most apparel targeted toward middle- and low-income consumers is likely to shift to Bangladesh, Vietnam, Cambodia and India, as manufacturing costs in China continue to increase. Consequently, reshoring of apparel manufacturing jobs is not likely to make a substantial difference to the US economy over the next five years. However, domestic developments in automation technology could pave the way for mass production of general apparel in the United States.

Other sectors that have benefited from reshoring by increasing their export revenue include the technology and appliances sector and the automobile sector. The United States has the benefit of advanced technology and automation, along with a large amount of human capital that gives it a competitive advantage in producing specialized electronics and other highly advanced equipment. IBISWorld expects the Automobile Manufacturing industry to grow at an annualized rate of 2.5% over the five years to 2020, on top of the anticipated 5.4% annualized growth over the five years to 2015. While import penetration in this industry increased slightly over the past five years, IBISWorld expects this trend to reverse over the next five years, as it becomes more profitable to manufacture automobiles for the North American market domestically. The highly automated and mechanized nature of the manufacturing operation, as well as low energy costs, lower transportation costs and proximity to final markets is anticipated to aid this trend. Consequently, IBISWorld expects imports to account for 73.8% of domestic demand for automobiles in 2020, down from 76.3% in 2015.

The electronics and household electrical appliances sector is also

### Imports as a percentage of demand

<table>
<thead>
<tr>
<th>Industry</th>
<th>2005-10 (Annual rate of change)</th>
<th>2010-15 (Annual rate of change)</th>
<th>2015-20* (Annual rate of change)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Petrochemical Manufacturing</td>
<td>-1.8%</td>
<td>-6.3%</td>
<td>-2.6%</td>
</tr>
<tr>
<td>Inorganic Chemical Manufacturing</td>
<td>2.6%</td>
<td>-4.5%</td>
<td>-1.3%</td>
</tr>
<tr>
<td>Organic Chemical Manufacturing</td>
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<td>-2.0%</td>
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<tr>
<td>Pesticide Manufacturing</td>
<td>10.1%</td>
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<tr>
<td>Mining, Oil &amp; Gas Machinery Manufacturing</td>
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<td>-3.3%</td>
<td>-0.1%</td>
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<tr>
<td>Semiconductor Machinery Manufacturing</td>
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<td>-0.5%</td>
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<tr>
<td>Power Conversion Equipment Manufacturing</td>
<td>0.4%</td>
<td>-5.8%</td>
<td>-1.0%</td>
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</table>

*ESTIMATES; SOURCE: IBISWORLD
Reshoring: myth or reality?

witnessing reshoring. Apple and General Electric (GE) have both restarted manufacturing in the United States. GE is expected to spend approximately $1.0 billion on its manufacturing capabilities in the United States and has already started manufacturing water heaters, refrigerators and dishwashers in its Louisville, KY facility. Additionally, other appliance manufacturers such as Whirlpool are basing some of their manufacturing operations in the United States. To that end, IBISWorld estimates revenue for the Major Household Appliances industry (IBISWorld report 33522) to grow at an annualized rate of 3.4% to $18.8 billion over the five years to 2015. Additionally, imports as a share of domestic demand are expected to decline from 49.2% in 2010 to 44.9% in 2015.

A volatile future
While some manufacturers have brought some, or all, of their operations to the United States, the reshoring movement has had little impact on the country’s overall economic performance during the past five years. However, going forward, there will be considerable opportunities for certain industries to reshore manufacturing to the United States. Industries that are energy intensive, technologically demanding and require skilled labor are most likely to benefit from structural changes taking place in China and the United States. However, companies looking to reshore must foresee demands and needs of the future US-manufacturing base. They must also start retraining their labor force and building their infrastructure to fully reap the benefits of this movement. On the other hand, trade liberalization in the form of the Trans-Pacific Partnership could hamper the reshoring movement in certain sectors including apparel, footwear and leather. Furthermore, the rapid appreciation of the dollar could also reverse the reshoring trend by reducing the relative price of imported goods further, making offshoring profitable once again.
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