The piece argues that "manufacturing onshoring" has not produced any tangible results in boosting industrial output and employment. It delves into the reasons behind this policy failure and explores the financial market implications of "onshoring" and "friend-shoring" policies.

ALPINEMACRO
A Unique Mind On The Markets

SPECIAL REPORT

September 2, 2024

U.S. Manufacturing Renaissance: Still A Mirage

"Right now as we speak, large factories are being built across the border in Mexico... We don't mind it happening but plants will be built in the United States and our people are going to man those plants. And if they don't agree with us, we'll put a tariff of approximately 100-200% on each car and they will be unsellable in the United States."

fascist fool*- Donald Trump

In This Report

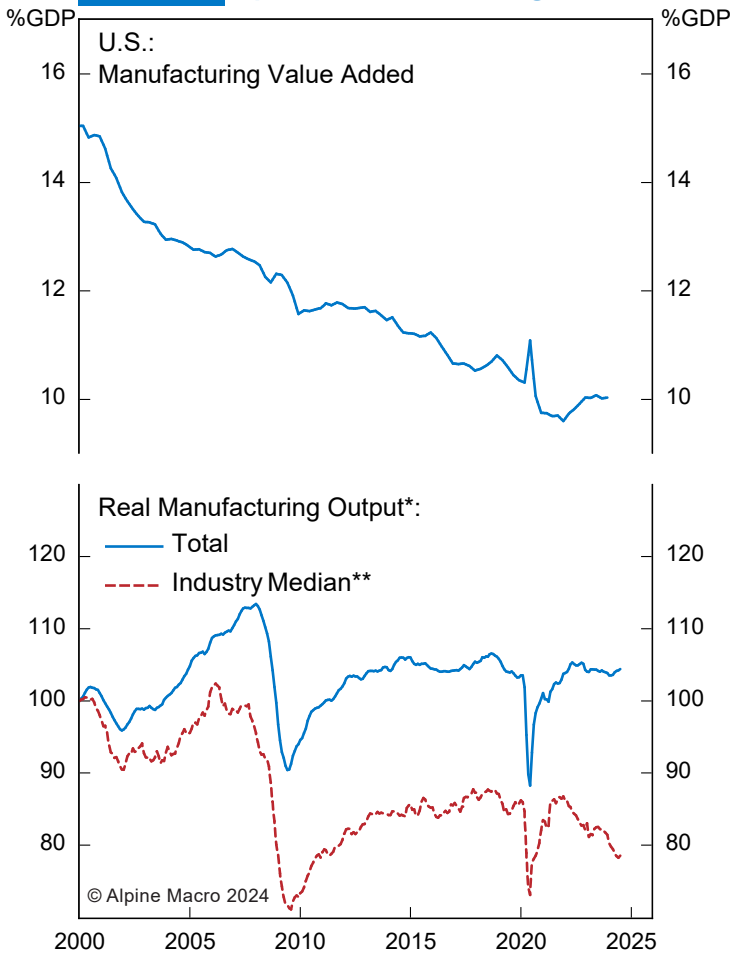
"Bringing manufacturing home" has been a key U.S. economic policy since the Trump administration. From Trump's Sino-U.S. tariff war to the Biden administration's three Acts, the focus has been squarely on protecting, promoting, and rebuilding domestic manufacturing.

The COVID-19 pandemic and the intensifying China-U.S. rivalry have not only raised the urgency of this agenda but also garnered strong bipartisan support. Eight years after Trump first championed this policy, is there truly a manufacturing renaissance? Unfortunately, U.S. "onshoring" efforts have so far yielded little to no tangible results.

Taking Stock Of The Facts

At the onset, manufacturing value added has steadily declined from 23% of GDP in the early 1970s to 10% today (Chart 1). While quality-adjusted output has treaded water since the turn of the millennium, a more troubling trend is the 20% drop in median sub-industry output, which highlights how a few key sectors have buoyed the overall measure.

Chart 1 Spot The Manufacturing Revival



*Rebased to Jan 2000=100; shown as 3-month moving average
**Based on 50 sub-industries

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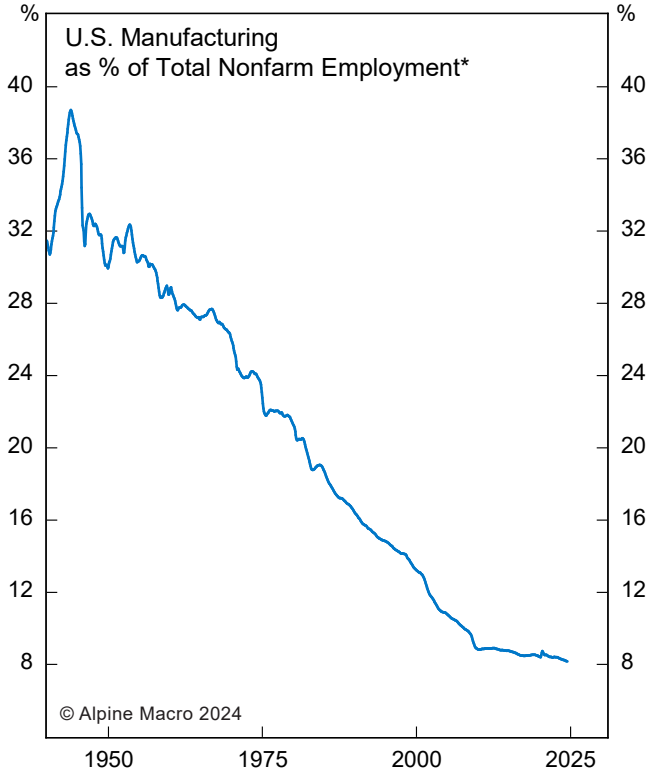
Chart 2 Manufacturing Employment Remains In Secular Decline

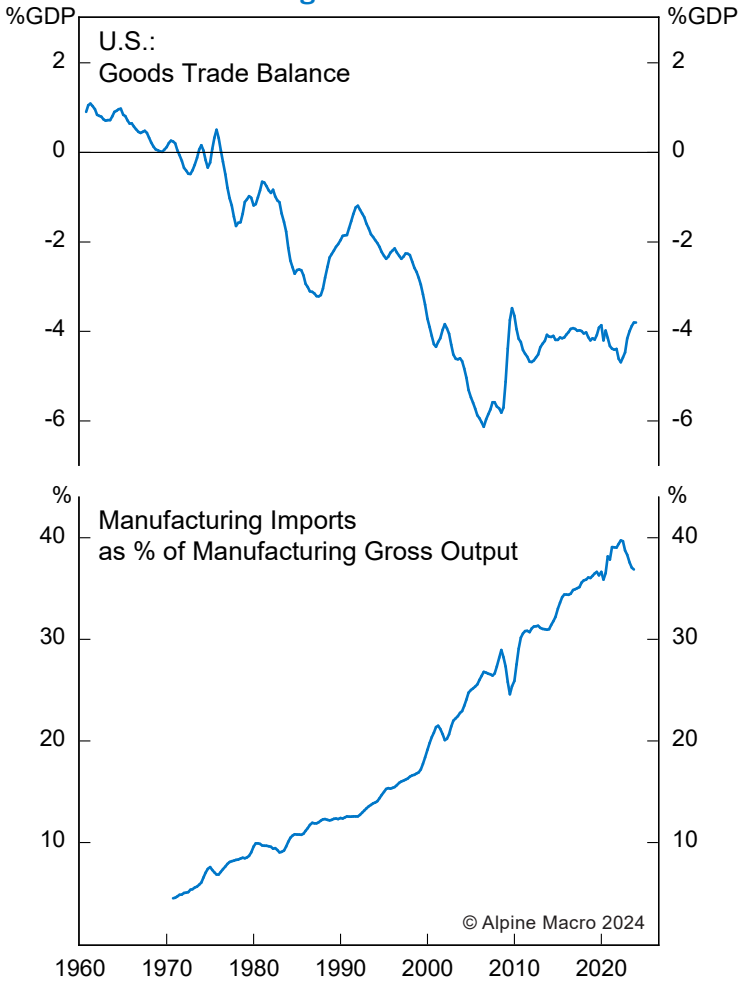


*Production and non-supervisory employees; shown as 3-month moving average

In terms of employment, the secular drop in manufacturing payrolls has continued, although there has been a gain of 1.5 million manufacturing jobs since 2010. However, this gain has only partially recovered the colossal 6 million jobs lost in the 2000s. The pace of hiring remains sluggish, leaving the share of manufacturing employment at 8% and sustaining its long-term decline (**Chart 2**).

The external balance also underscores the fact that the U.S. continues to consume significantly more imported goods than it produces, as evidenced by the merchandise trade deficit of around 4% of GDP (**Chart 3**). Similarly, imports of manufactured goods have far outpaced domestic production, reflecting the continued reliance on foreign products.

Chart 3 An Addiction To Foreign-Produced Goods



There has certainly been a sharp spike in manufacturing investment, but its relative scale is so small that it makes no difference for the overall economy. As shown in **Chart 4**, overall fixed asset formation has remained essentially flat over the past four decades, indicating that the manufacturing investment boom is confined to very narrow sectors, such as semiconductors.

Furthermore, capital outlays on equipment have persistently fallen as a share of GDP, from about 8% in the early 1980s to just 5% today. This slower pace of capital accumulation is closely tied to diminishing

Chart 4 No Sign Of A Broad Investment Boom

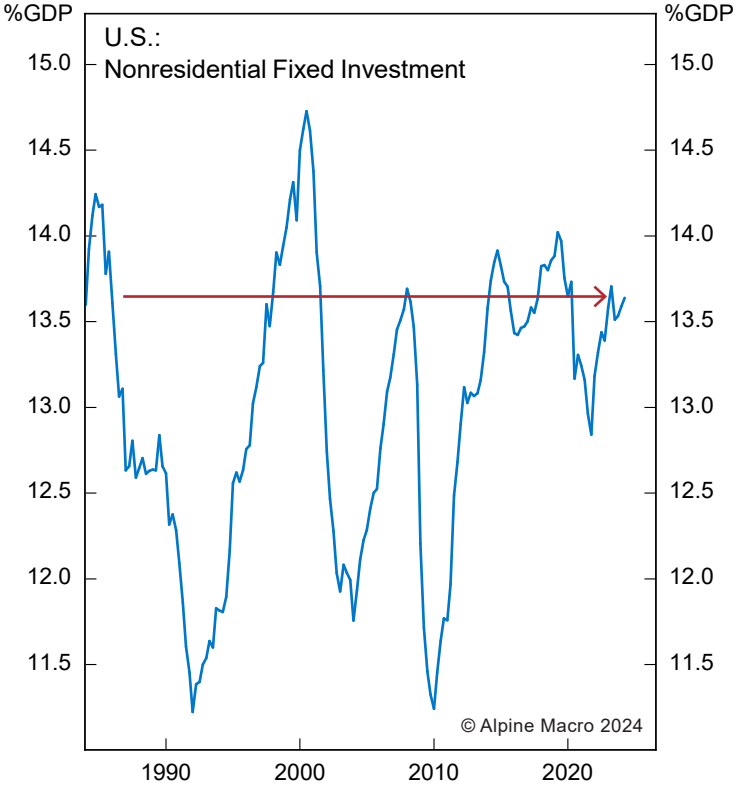
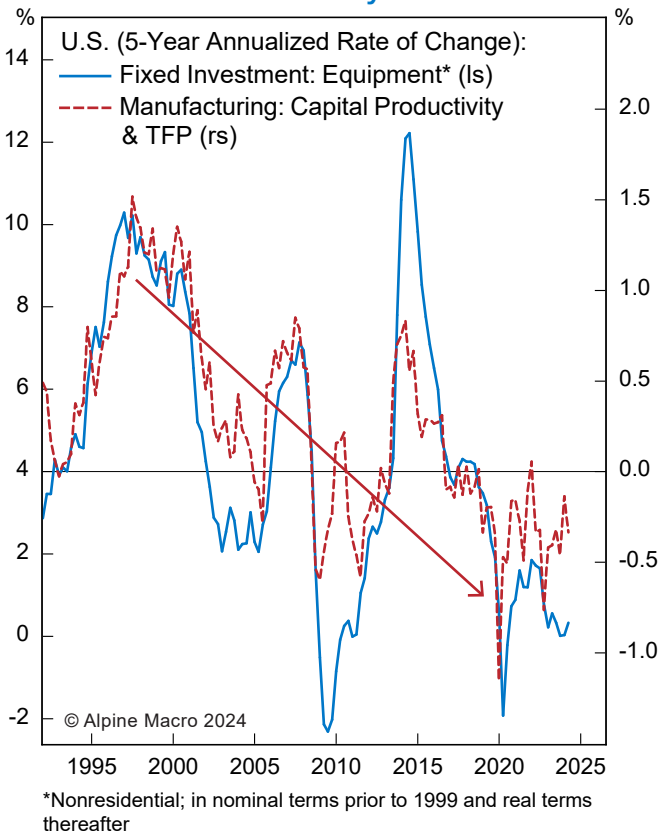


Chart 5 Manufacturing Has A Productivity Problem



*Nonresidential; in nominal terms prior to 1999 and real terms thereafter

capital and multi-factor productivity within manufacturing, particularly compared to other segments of the U.S. economy (**Chart 5**).

The bottom line is that the preferential policies and subsidies of recent years have failed to reverse the trend of falling manufacturing in the overall economy. While they may have made it more difficult for Chinese suppliers to sell into the American market, they have not made the U.S. any more self-sufficient in the supply of manufactured goods.

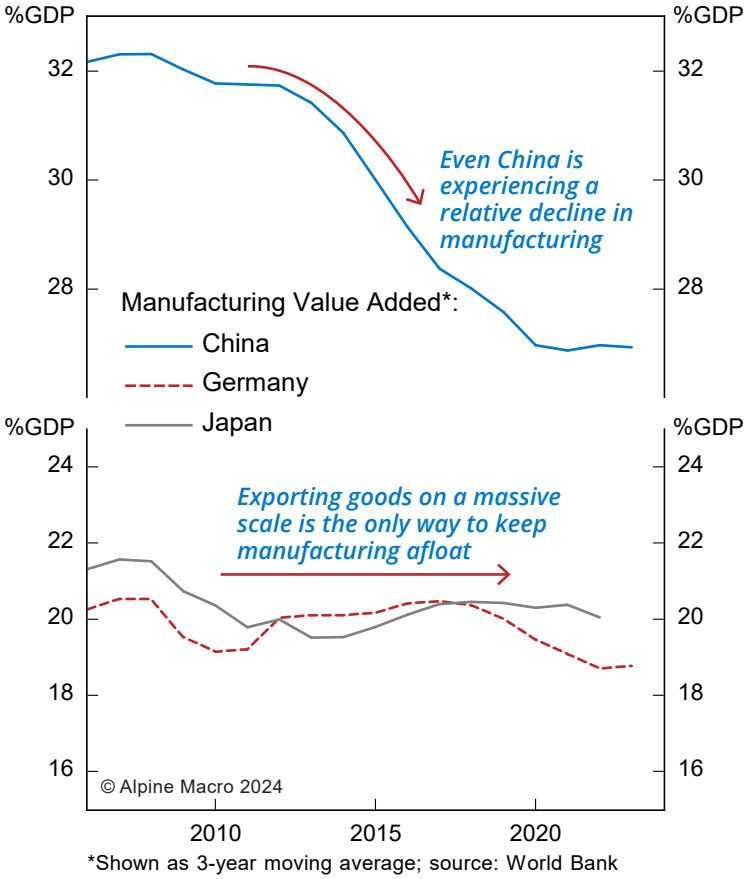
The Reasons Behind The Failures

First, the U.S. government's efforts to rebuild the manufacturing industry are fundamentally at odds with economic evolution and logic. Most countries experience a decline in their manufacturing sectors as GDP per capita or labor productivity increases. Even China has seen its manufacturing share of GDP begin to drop since 2008 (**Chart 6**, top panel).

Manufacturing typically drives productivity growth within an economy, and this means that incrementally fewer workers are needed to produce an ever-increasing amount of output. At the same time, as income levels rise, goods consumption will continue to grow, but it will make up a diminishing portion of the overall consumption basket. Therefore, services will outpace manufacturing as income levels continue to rise and consumers become increasingly more affluent.

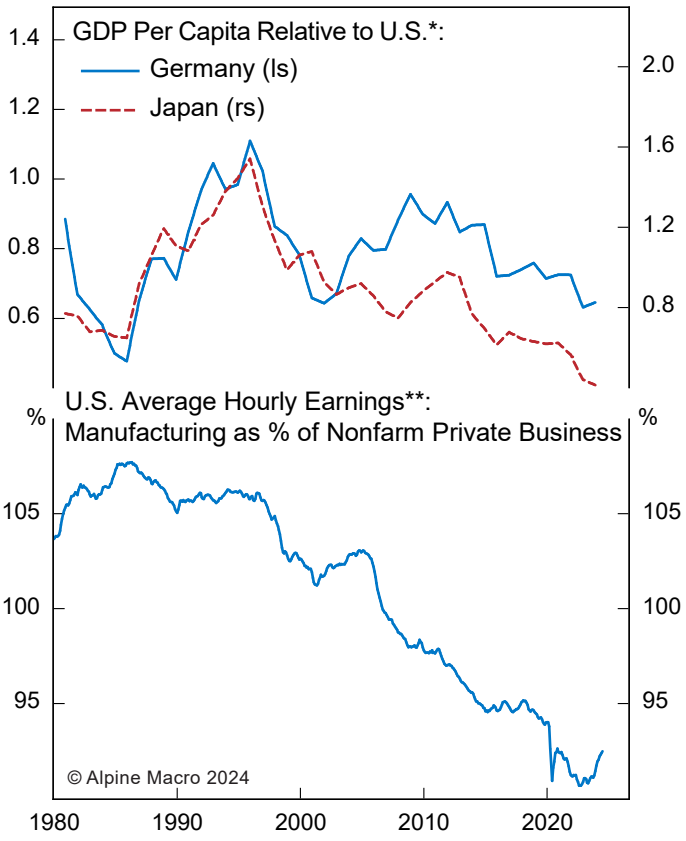
This trend is irreversible, reflecting the shift of most high-income economies to a post-industrial

Chart 6 Expanding Manufacturing Is Difficult In Post-Industrial Phase



*Shown as 3-year moving average; source: World Bank

Chart 7 What Is So Great About Manufacturing Jobs?



*Source: IMF
**Production and non-supervisory employees; shown as 3-month moving average

structure. For these high-income economies, the only viable way to significantly expand their manufacturing sectors is to export goods to other nations on a massive scale.

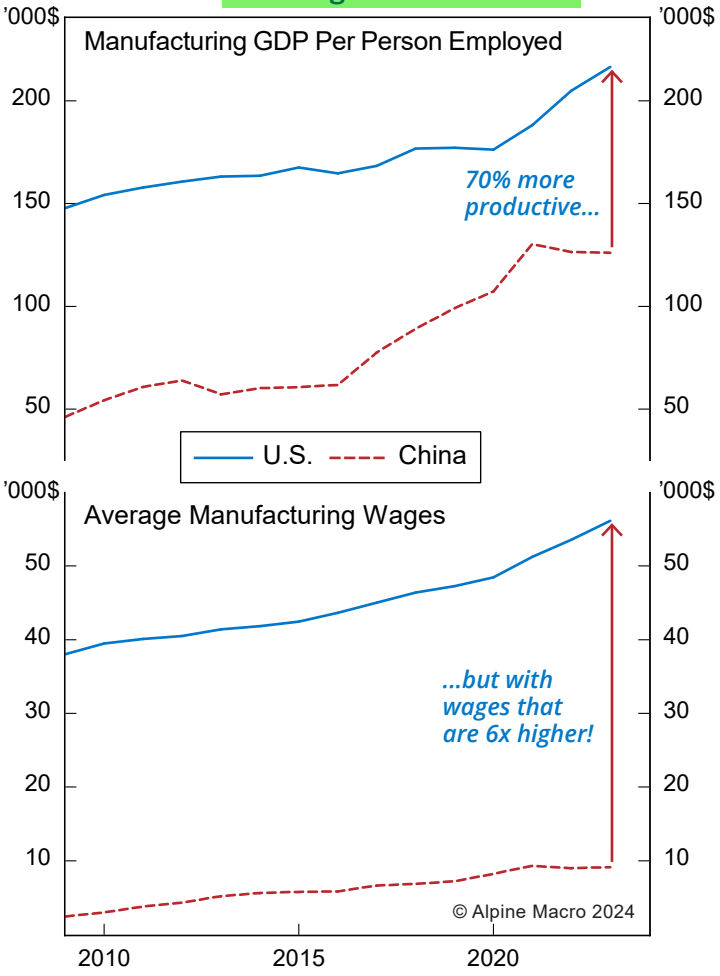
Typical examples include Germany and Japan. In Germany, manufacturing as a share of GDP has stopped falling since the 1990s. With limited domestic goods consumption, Germany's substantial manufacturing base has led to a massive rise in net exports.

The situation in Japan is quite similar, with manufacturing as a share of the economy stabilizing at around 20% (**Chart 6**, bottom panel), while its reliance on exports has continued to increase.

Crucially, maintaining a high proportion of manufacturing in these economies has not translated into higher income growth compared to the U.S. In fact, since the early 1990s, both Germany and Japan have seen their relative income levels materially decline relative to the U.S. (**Chart 7**).

Second, it is factually incorrect to say that manufacturing jobs in the U.S. are better paying jobs. Relative manufacturing wages have eroded over four decades and are now nearly 10% lower than the average private sector wage (**Chart 7**, bottom panel). This trend is likely reflective of the inevitable shifts in factor returns characteristic of a post-industrial economy.

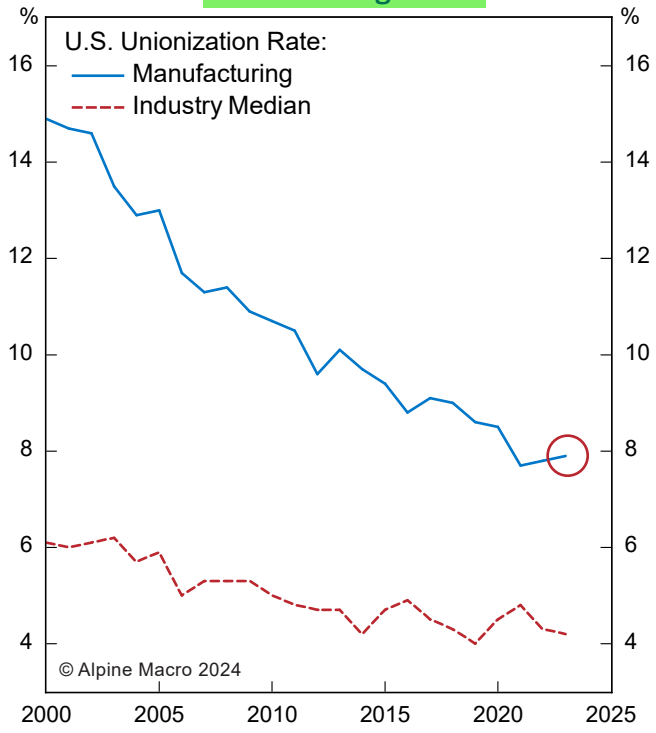
Chart 8 The U.S. Cannot Be Competitive Given High Unit Labor Costs



For instance, workers engaging in high value-added services or technological innovations should be, and have been, earning much more income than assembly line workers. In this vein, one might question the benefits of creating more manufacturing jobs than, say, software designers or AI programmers.

Third, the U.S. is hyper-competitive in manufacturing sectors such as aerospace, medical devices, and advanced machinery. However, expanding manufacturing beyond these specialized industries would encounter significant challenges, namely higher relative wages and low relative efficiency.

Chart 9 Unions Are An Albatross Around Manufacturing's Neck



To illustrate, China's manufacturing industry produces $4.7 trillion in GDP while employing 37 million workers. In the U.S., annual manufacturing GDP is $2.8 trillion, which is produced by 13 million workers (**Chart 8**, top panel). In other words, American workers are about 70% more productive than their Chinese counterparts. Yet, the former still earns more than *6 times* the income of the latter (**Chart 8**, bottom panel).

Relatively high real wages in U.S. manufacturing can be partly attributed to the prevalence of unions within the industry. Although unionization rates have declined, they remain nearly double that of the industry median (**Chart 9**). Of course, restrictive work rules imposed by unions are also likely to limit operational flexibility and reduce incentives for efficiency improvements.

Moreover, the much higher per capita income levels in the U.S. compared to the rest of the world, particularly developing countries, have severely constrained how much cost compression a U.S. manufacturer can achieve domestically, unless that manufacturer relocates to countries with much lower income levels.

For example, it is nearly impossible for American companies to compete in labor-intensive industries with the vast number of low-income countries, no matter how efficient they are. Even China has been shifting its labor-intensive manufacturing operations to countries such as Vietnam and Cambodia.

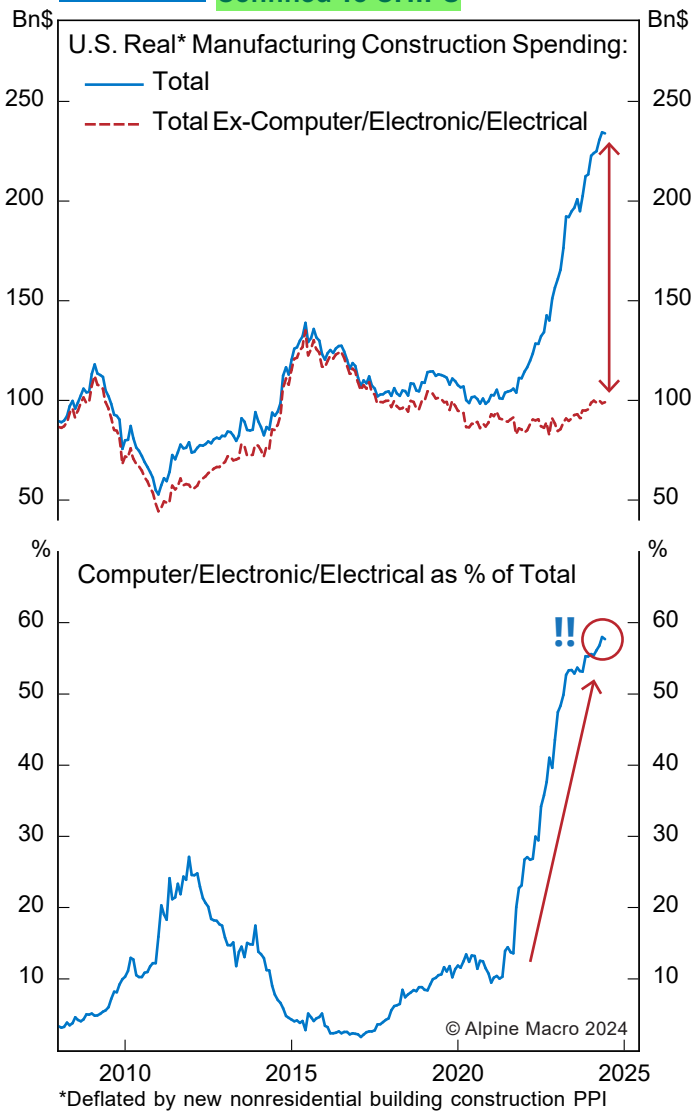
Finally, there is a lack of a clear and coherent objective behind the policy of bringing manufacturing back to the U.S. What exactly is the goal? Is it full self-sufficiency in supplying manufactured goods, partial self-sufficiency, or something else?

The economic feasibility of these goals, along with their advantages and disadvantages, has never been thoroughly examined. If the aim is for the U.S. to achieve self-sufficiency, it would require American workers accepting significantly lower wages and may involve long-term government subsidies, while American consumers must pay significantly higher prices for goods. None of these is politically viable.

Political Rhetoric Versus Economic Reality

Blaming domestic pain on foreign countries is politically convenient. To a large extent, much of the narrative surrounding a manufacturing revival appears to be a politically motivated strategy targeting suffering audiences in swing states, especially in the

Chart 10 Investment Boom Is Confined To CHIPS



*Deflated by new nonresidential building construction PPI

Rust Belt. Unfortunately, while these narratives may be appealing to many manufacturing workers in the U.S., they are unlikely to produce meaningful results.

For example, Democrats have generally favored gargantuan industrial policies to finally reverse the tide in favor of manufacturing. Proponents of legislation such as the CHIPS Act and Inflation Reduction Act (IRA) point to the nearly $400 billion investment committed to date for building facilities onshore.

Besides, the increase in investment was entirely due to chips-related activities (**Chart 10**).[1] This suggests that the provisions contained in the IRA for encouraging domestic manufacturing in other critical technologies – such as electric vehicles, electric batteries, and green energy tech – have had no discernible impact.

There is also serious doubt as to whether there is enough skilled labor in the pipeline to fill potential demand.[2] Manufacturing ranks lowest among fields in which high school graduates earn a Carnegie (CTE) credit, with only 4% of students earning credits in this area (**Chart 11**).[3] It is also worth noting that people under the age of 25 make up only 9% of the manufacturing workforce, compared to 13% for all other industries.

Additionally, the efficacy of the fiscal largesse may simply be undone by bureaucratic red tape. A recent headline declared that $84 billion in large manufacturing investments, or about 40% of the total announced, have been delayed or indefinitely paused.[4] In the face of the U.S.'s escalating strategic rivalry with China, such delays would likely lead to irreversible setbacks in establishing crucial manufacturing industries.

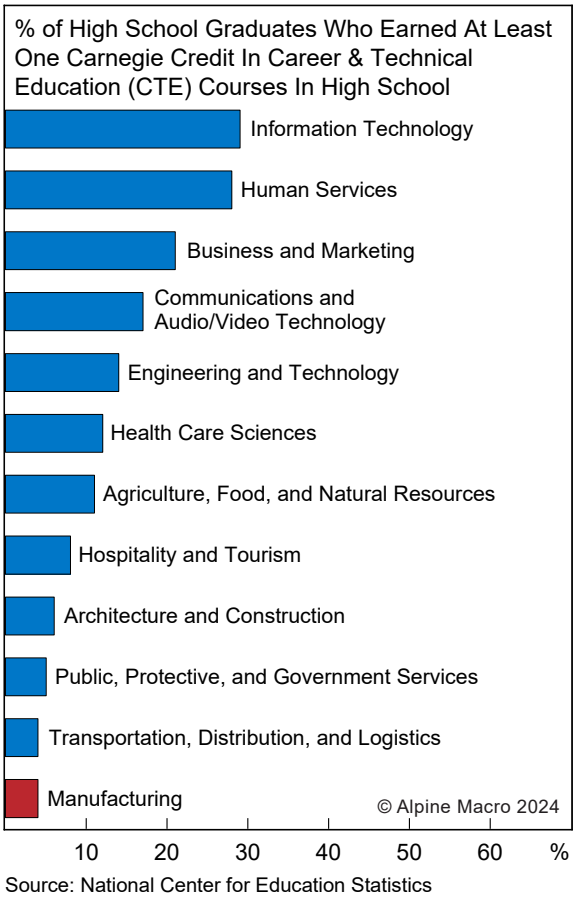
1 A counterfactual can be made that much of these investments might have occurred anyway. U.S. firms were grappling with significant supply chain bottlenecks related to chip sourcing in 2020-21 and were already working to lessen their reliance on foreign suppliers.

2 The ability of this legislation to generate a meaningful number of new jobs remains an open question. For instance, TSMC's much-heralded fab investments are expected to employ just 6,000 workers. In turn, the company will receive $6.6 billion in grants, which amounts to $1.1 million per job.

3 These credits represent academic achievement in vocational and technical education.

4 "Delays hit 40% of Biden's major IRA manufacturing projects", Financial Times (August 12,2024).

Char 11 **Lack Of Interest Among Youths In Manufacturing Careers**



Source: National Center for Education Statistics

As for Republicans, they have largely embraced Trump's reliance on tariffs. However, these blunt tactics are destined to produce distortions and inefficiencies. Rather than achieving their intended goals, tariffs are more likely to expedite the rerouting of supply chains to lower-cost economies not directly targeted. Trump has promised to slap a 10% tariff on all imported goods and a 60% tax on Chinese imports. If enacted, these high tariffs may shield U.S. manufacturers from foreign competition, but will lead to higher prices for consumers due to import substitution costs over time. In the end, the standard of living for the average American will be reduced as a result.

Market Implications

As far as investors are concerned, there are three key takeaways.

First, there is no indication that industrial stocks are benefiting from recent U.S. policies. In fact, the sector continues to underperform, mirroring the relative decline in manufacturing productivity (Chart 12). This is unsurprising, given that corporate profits are closely tied to productivity. With little prospect of a structural turnaround in the latter, any relative rebounds in industrials are likely to be modest and short-lived.

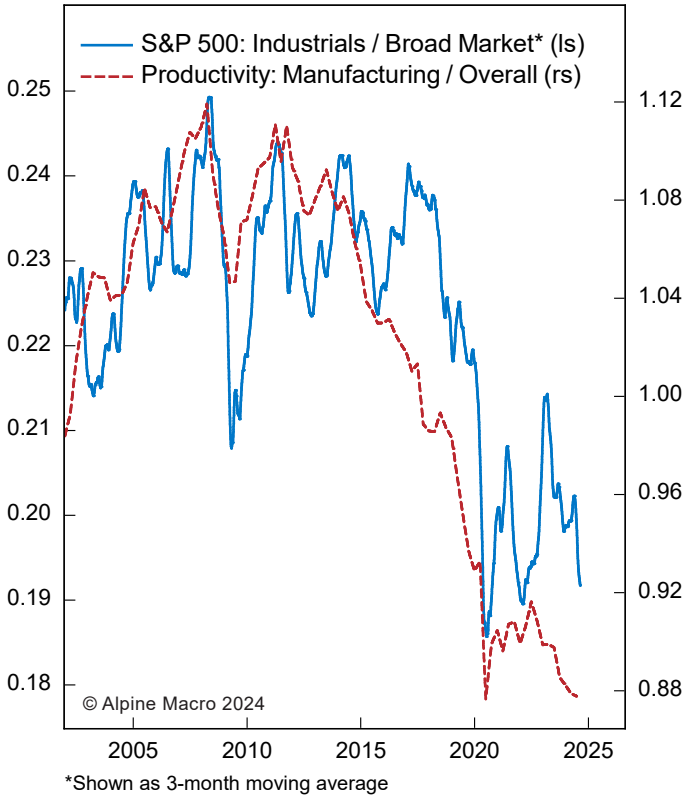
v true. what good is the supply when there is a shunning of demand

Second, while the U.S. chip sector should gain from subsidies, it will almost certainly lose out due to tightening export controls. In 2021, China accounted for $18 billion, or about 23%, of U.S. semiconductor and circuit-related exports. Since then, this figure has roughly halved, and China is no longer the U.S.'s largest market for these goods. Instead, China has emerged as the key producer of low-end semiconductor chips. As Chinese companies and the government invest heavily in domestic semi production, the risk of permanently losing this market for American producers increases, along with the likelihood of intensified competition in the longer run.

Finally, while onshoring efforts have fizzled, friend-shoring is gaining traction. Several countries with wage levels and economic complexity comparable to China are poised to benefit from persistent U.S.-China "de-risking". Vietnam, Malaysia, India and Mexico stand out as prime candidates in offering new investment opportunities.

Bassam Nawfal
Chief Asset Allocation Strategist

Chart 12 Industrials Under Structural Downward Pressure



Investment Recommendations						
Tactical Investment Positions (3 - 6 months)						
Recommendations	**Open Date**	**Open Levels**	**Stop**	**Closing Date**	**Closing Levels**	**P&L Since Inception**
Long U.S. Regional Banks (ETF: KRE)	12/04/2023	48.12	53	-	-	23.2%
Long Russell 2000 (ETF: IWM)	08/19/2024	215.20	-	-	-	2.3%
Long Gold (ETF: GLD)	04/01/2024	207.82	-	-	-	11.3%
Long Nikkei 225 Unhedged	08/19/2024	37,389	-	-	-	3.5%
Long Long-Dated Treasury Bonds (ETF: TLT)	06/10/2024	90.89	95	-	-	6.9%
Long U.S. Financials (ETF: IYF)	08/19/2024	101.30	-	-	-	3.7%
Short Brent Oil[1]	08/26/2024	80.00	-	-	-	3.8%

Note: P&L is calculated using daily closing prices.
[1] Our stop sell Brent Oil at $80 was triggered on 08/26/2024.