

US Trade Policy and Reshoring: The Real Impact of America's New Trade Policies

The US has made significant changes to its trade policy with the specific intent of bringing manufacturing home. So why haven't these policies resulted in an uptick in reshoring?



The United States has made significant changes to its trade policy, with the specific intent of bringing manufacturing home. Yet just as these policies are starting to show their impact, imports from 14 traditional low-cost offshore countries have grown at historic rates.

Now that the official government numbers for 2018 have been released, A.T. Kearney's 6th annual Reshoring Index confirms that growth in manufactured goods imports into the United States from the 14 largest low-cost country (LCC) trading partners in Asia rose by \$66 billion or 9 percent for the year, the largest annual increase since the beginning of the economic recovery.¹ US gross manufacturing output, by comparison, grew only 6 percent year-over-year (YoY) in 2018.

As a result, the A.T. Kearney Reshoring Index decreased for the third year in a row, by 32 basis points (bps), indicating that manufacturers continue to view LCCs as a more desirable location than the US to produce or purchase a wide variety of goods, notwithstanding the trade measures emanating from Washington, D.C. (see sidebar: 2018 US Reshoring Index: A Closer Look on page 2).

This year's white paper also includes our new China Diversification Index, which studies the trend of manufacturers seeking to shift their supply and production bases away from the "China Factory." The paper evaluates the impact of recent trade disputes on this diversification and its impact on US reshoring, and considers different potential scenarios for US manufacturers.

Backfiring Policies

Trade tensions with all of America's top trading partners have been commanding headlines for the last 12 months. Most prominently, three rounds of like-for-like tariffs were exchanged between the US and China.

By September 2018, tariffs on the order of 10 percent to 25 percent were in effect on \$250 billion worth of Chinese imports, nearly half of China's 2018 US import volume. China, in kind, levied tariffs on \$110 billion worth of US imports to China. The conflict escalated this year as trade talks collapsed with Beijing and the US enacted a fourth round of tariffs—an increase from 10 percent to 25 percent on \$200 billion worth of Chinese imports. The threat of tariffs on all remaining Chinese imports—worth an additional estimated \$286 billion—continues to loom. Negotiations between the United States and China are ongoing, however just when and how the trade war will conclude remains as uncertain as ever.

Beyond China, tensions have escalated with other US trading partners also. **Tariffs on steel and aluminum** went into effect June 1, 2018 as part of Section 232 of the Trade Expansion Act. This action followed on the heels of similar tariffs applied to several other trading partners. The new rule levied tariffs of 25 percent on steel and 10 percent on aluminum on imports originating from Canada, Mexico, and the EU. **Retaliatory tariffs** ensued, with the EU announcing tariffs on selected US goods, including motorcycles and bourbon.

At the same time, 2018 marked the first year of the **foreign derived intangible income (FDII) tax deduction**, a tax policy incentivizing US companies to reshore. FDII allows companies to claim a deduction on any income generated from goods produced in the US and sold overseas. The deduction reduces the tax rate on this income from 21 percent to 13 percent between now and 2025. However, the effective tax rate inches up to 16 percent after 2025.

¹ 2010 represented the largest growth in YoY imports in the past 10 years due to a recuperation of import levels vs. 2009; 2009 saw a 14 percent decline in imports vs. 2008 driven by the Great Recession.

2018 US Reshoring Index: A Closer Look

The objective of the A.T. Kearney US Reshoring Index is to assess actual reshored manufacturing—not manufacturing related to foreign direct investment (FDI), which implicates a very different set of economic factors. The Index compares US manufacturing

gross output to import data from 14 low-cost countries (LCCs).

To calculate the US Reshoring Index, we first look at the import of manufactured goods from 14 traditional offshore trading partners: China, Taiwan,

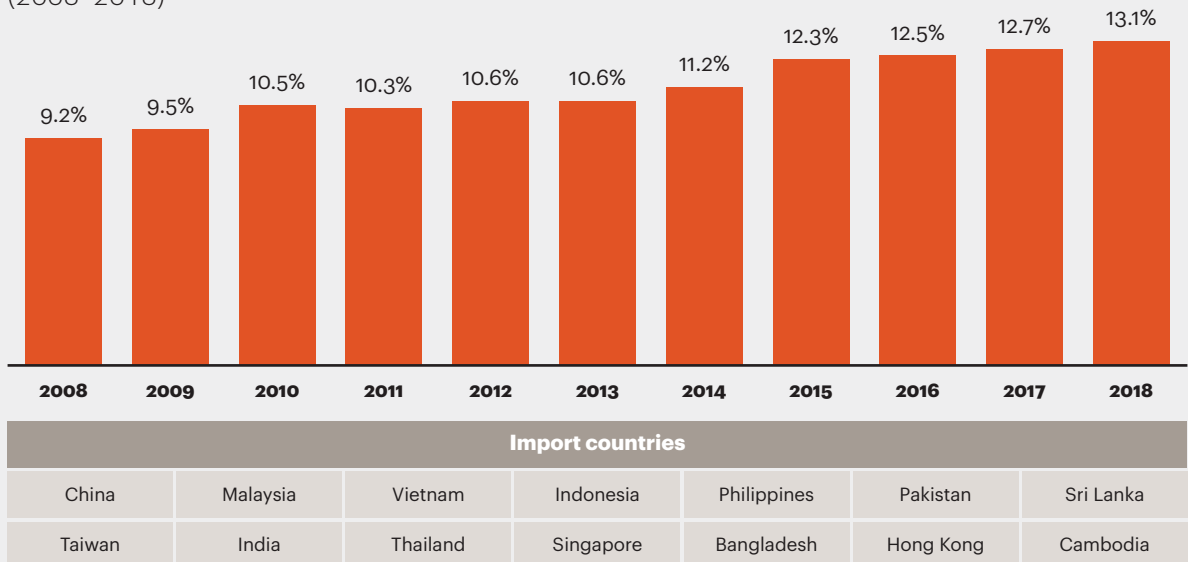
Malaysia, India, Vietnam, Thailand, Indonesia, Singapore, Philippines, Bangladesh, Pakistan, Hong Kong, Sri Lanka, and Cambodia. Next, we examine US domestic gross output of manufactured goods.

Figure A

The manufacturing import ratio grew for the fifth consecutive year in 2018

US manufacturing import ratio (MIR) = total manufactured goods imports as % of domestic manufacturing gross output

(2008–2018)



Sources: United States International Trade Commission, United States Department of Commerce Bureau of Economic Analysis; A.T. Kearney analysis

So why haven't America's new trade and tax policies resulted in an uptick in reshoring? For starters, the fundamental economic benefits of manufacturing in low-cost countries vs. the US have not significantly changed, and the FDI tax benefits have not outweighed the still significantly lower unit costs to manufacture offshored products.

Yes, manufacturing in China continues to get more expensive due to tariffs, but it was already heading in that direction as labor costs have continued to creep upward over the past several years. That has led, for the past decade, to manufacturers executing strategies to shift operations to LCCs such as Vietnam and India. So rather than incentivizing manufacturers to reshore, the trade spat with China has just accelerated this ongoing shift toward those countries.

Then, we calculate the manufacturing import ratio (MIR), which is simply the result of dividing the first number by the second. The US Reshoring Index is the year-over-year change in the MIR, expressed in basis points. A positive number indicates net reshoring, or a growth in gross domestic output that exceeded the growth of imports from the 14 LCCs.

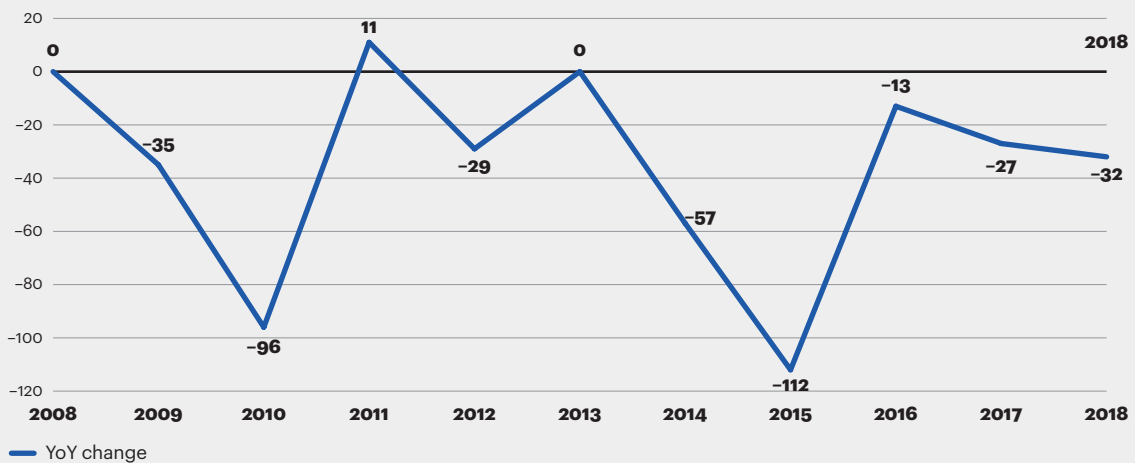
In 2018, imports of manufactured goods from offshore trading partners reached \$816 billion. US domestic gross output of manufactured goods reached \$6,249 billion in 2018. As a result, the manufacturing import ratio for 2018 is 13.1 percent, meaning there were 13.1 cents worth of offshore production bound for the US market for every \$1 of domestic manufacturing gross

output (see figure A).

This is the highest MIR we've seen since we started tracking the Reshoring Index, and continues a trend of five years of consecutive growth in the MIR. The 2018 MIR shows a 32 basis point increase over 2017's MIR (12.7 percent), therefore the US Reshoring Index for 2018 is minus 32 (see figure B).

Figure B
The 2018 MIR increased by 32 basis points over 2017

A.T. Kearney Reshoring Index year-over-year change in the US manufacturing import ratio
 (Basis points, 2008–2018)



Note: MIR is manufacturing import ratio.
 Sources: United States International Trade Commission, United States Department of Commerce Bureau of Economic Analysis; A.T. Kearney analysis

When manufacturers do consider bringing production back to North America, they opt to “nearshore,” particularly to Mexico. This trend has picked up considerable momentum in the past year, in large part due to US–China tensions, as well as to progress on the United States–Mexico–Canada Agreement (USMCA). But here as well, the more recent trends merely represent a continuation or slight acceleration of previously existing momentum, as we indicated in 2016 when we wrote “Is Mexico Stealing America’s Reshoring Lunch?”

Ultimately, trade and tax policies may contribute to some rebalancing of the production equation. As of now, however, these policies may not have had enough time to mature. The confrontation with China is at a stalemate and manufacturers are uncertain as to the end outcome of trade negotiations with the EU, Japan, India, and other key partners.

Many executives are also waiting to see whether the FDII will survive a potential legal challenge before the WTO claiming that the deduction constitutes a backdoor subsidy in violation of the Agreement on Subsidies and Countervailing Measures (SCM). Lacking clarity on what the future will hold, most manufacturers are hesitant to make the heavy investments required to reshore.

Despite 2018 trade and tax policies, LCC imports have grown relative to US domestic output. Whether this trend will continue in 2019 will be largely dependent on the state of America's multi-front trade war.

While it may be too early to judge whether large-scale reshoring will ever result from recent policy changes, US manufacturing has already started feeling negative effects. Steel and aluminum tariffs, for example, have increased input costs and decreased profits. Retaliatory tariffs imposed by China and other leading trade partners have many CEOs evaluating opportunities to shift production out of the US to avoid the impact of tariffs.

Despite 2018 trade and tax policies, LCC imports have grown relative to US domestic output. Whether this trend will continue in 2019 will be largely dependent on the state of America's multi-front trade war. Q1 2019 results so far show absolute decreases in total imports from our LCC partners, particularly China.

However, there has also been a 150 bps decrease in total US manufacturing output since December 2018. This may be an indicator of a broader trade downturn that threatens both the US and its partners. If the conflict with China is resolved, bringing tariffs down to 2017 levels and increasing China's purchases of US manufactured goods, the trade outlook may brighten. But if increased tension between the US and its trading partners persists or escalates, we may simply be seeing the first harbingers of a considerably darker scenario.

If the US and China Aren't Winning, Who Is?

There are certainly winners coming out of the US-China trade fight. As China suffers, other Asian LCCs and Mexico have gained.

As part of this year's report, we tried to quantify the benefits to some of these winners by looking at the **A.T. Kearney China Diversification Index (CDI)**, a pulse-check on how China's share of US imports—as a percentage of total imports from our group of 14 Asian LCCs—is evolving. The CDI indicates that **China's role as "the factory of the world" is changing faster than anticipated.**

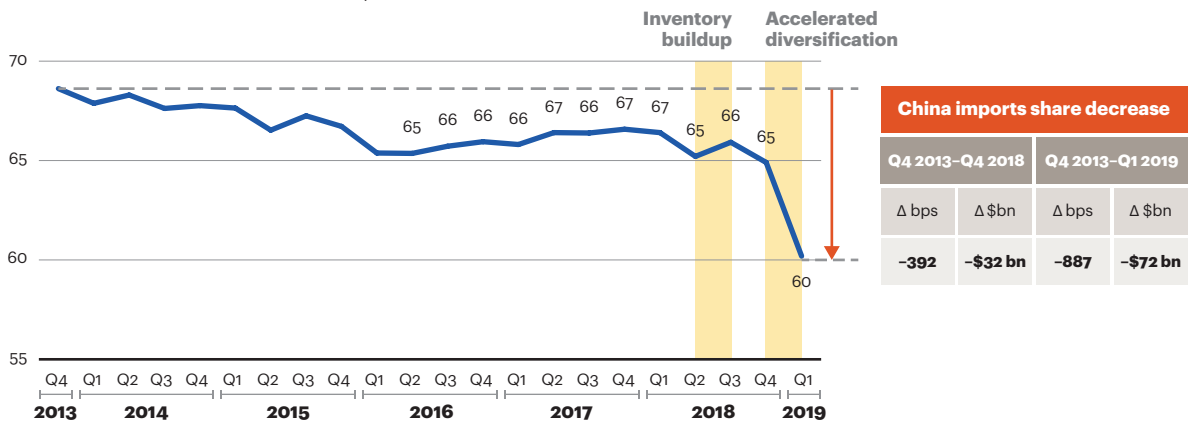
While China remains the largest source of US imports, making up close to two-thirds of the \$816 billion total, the past five quarters have shown a considerable decrease in China's share of the total import pie (see figure 1 on page 5). Five years ago, China held 69 percent of total imports to the US from low-cost trading partners. As of Q4 2018, its share had fallen 400 bps to 65 percent.

Figure 1

Through Q4 of 2018, China's share of imports to the US had dropped 400 basis points in five years

A.T. Kearney China Diversification Index (CDI) seasonally adjusted share of US LCC import value from China¹

(%, 2013 Q4–2019 Q1, 100 bps = \$8 billion)



Import countries						
China	Malaysia	Vietnam	Indonesia	Philippines	Pakistan	Sri Lanka
Taiwan	India	Thailand	Singapore	Bangladesh	Hong Kong	Cambodia

¹ Includes US imports from Hong Kong

Notes: LCC is low-cost country. bps is basis points.

Sources: United States International Trade Commission; A.T. Kearney analysis

When layering on import data from Q1 2019, this trend becomes even clearer. China's share of total imports to the US decreased to 60 percent in Q1 2019, a 900 bps decrease from the previous quarter. **China's lost share is equivalent to a loss of \$72 billion in import value**, more than the total 2018 value of imports from India (\$51 billion), which holds the second-largest share of imports to the US within the LCC group.

The precipitous decline in China's share of imports in Q1 2019 is due partly to US firms' stockpiling of Chinese imports in Q3 2018 in anticipation of planned tariff hikes, and partly to structural shifts in manufacturers' sourcing strategies.

Manufacturers are diversifying away from China and toward lower-cost countries, with Vietnam leading the pack. Vietnam has captured an additional \$36 billion of import value, fully half of the \$72 billion lost by China (see figure 2 on page 6).

Nike and Adidas are examples of companies that have increased the share of their production in Vietnam—from about 30 percent to about 45 percent over the past 10 years—at the expense of China. Other manufacturers such as H1 Corp., a maker of electric bicycles, made the shift to Vietnam just last year as a direct result of trade tensions, with the explicit goal of evading tariffs on their exports to the US.

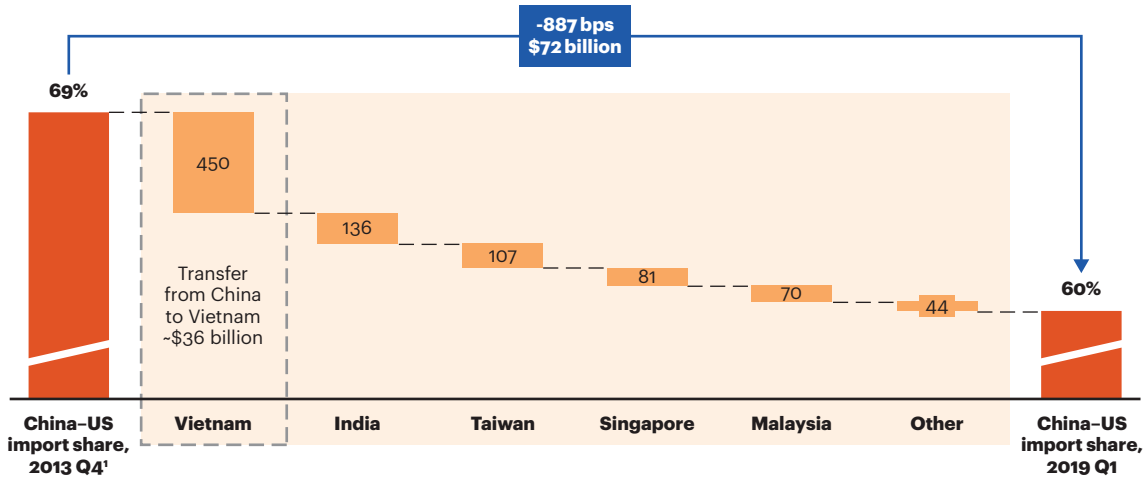
Over the five-year period between 2013 and 2018, Vietnam's imports to the US more than doubled, rocketing from \$21.7 billion to \$47.7 billion. This growth (a 17 percent compound annual growth rate, or CAGR, for 2013–2018) far surpassed the growth levels of all other Asian LCCs, which grew at an average CAGR of just 5 percent.

Figure 2

Manufacturers are diversifying to other low-cost countries, led by Vietnam

US LCC import share growth by country

(bps, 2013 Q4–2019 Q1, seasonally adjusted)



Import countries						
China	Malaysia	Vietnam	Indonesia	Philippines	Pakistan	Sri Lanka
Taiwan	India	Thailand	Singapore	Bangladesh	Hong Kong	Cambodia

¹ Includes US imports from Hong Kong

Notes: LCC is low-cost country. bps is basis points.

Sources: United States International Trade Commission; A.T. Kearney analysis

As we look at the YoY trend of Vietnam’s growth, we see that it accelerated 320 bps for the period 2017–2018, to 11.3 percent over the prior year (see figure 3 on page 7). **Vietnam’s imports to the US grew 36 percent** from Q1 2018 to Q1 2019, while China’s imports decreased 13 percent over the same period.² Should Vietnam continue to grow at this tremendous pace for the rest of 2019, it would translate into an additional gain of \$17 billion in import value.

The drivers of the Vietnam growth story are numerous, including labor costs lower than China’s, proximity to Southeast Asian supply chains, and a government whose policies are highly favorable to FDI. The maturation of Vietnam’s strategic infrastructure investments has certainly contributed to the recent spike in its imports as well. In May 2018, for example, the city of Haiphong opened its new deep-sea port, the Lach Huyen International Gateway Port, adding 300,000 twenty-foot equivalent units (TEUs) of capacity. The next phase of that project is scheduled to finish in 2020, and will bring total capacity up to 3 million TEUs.

While it is difficult to quantify the exact contribution, we expect that a big part of the spike in Vietnam’s import growth over the past five quarters is a result of companies hastening plans to shift sourcing out of China to avoid the impact of American tariffs. Certainly, if the tariffs persist, we expect Vietnam to continue to accelerate its growth of US import share, at China’s expense.

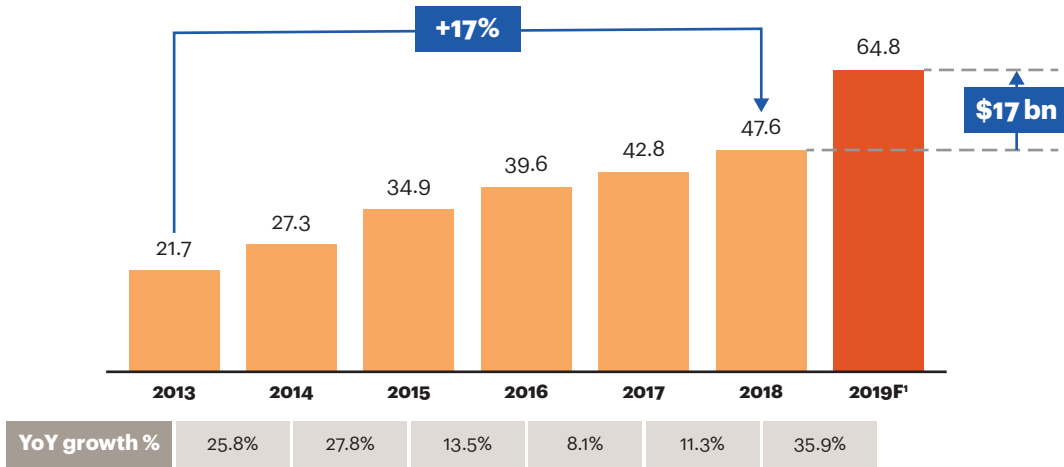
² Represents change in imports for China and Hong Kong combined, Q1 2019 vs. Q1 2018.

Figure 3

Vietnam's imports to the US, which more than doubled the past five years, skyrocketed in Q1 2019

US manufactured goods imports from Vietnam

(2013–2019F, CAGR and \$ billion, seasonally adjusted)



¹ 2019 forecast seasonally adjusted; forecast based on 2019 Q1 import data.
Sources: United States International Trade Commission; A.T. Kearney analysis

No Border Wall for Mexican Imports

Vietnam is not the only beneficiary of changes in US trade policies. As the US and China escalated tensions, Mexican imports to the US picked up considerable steam. In 2018, Mexico increased its exports to the US by \$28 billion, a growth rate of 10 percent over 2017—the fastest growth Mexico has seen in the past seven years.

While Mexico and the US have had their fair share of trade-related conflicts this past year, the magnitude of these disputes resembles a sibling quarrel compared to the brawl with China. US–Mexico tensions are calming; the US threat in June 2019 to place tariffs on 100 percent of Mexican goods until Mexico acted to reduce the flow of immigrants crossing the border was quickly resolved, with minimum sacrifice by either Mexico or the US. Renegotiation of USMCA is nearly complete, and the new agreement—which largely keeps intact the overall NAFTA framework—is likely to be ratified by all three countries' legislatures by the end of 2019, especially given the administration's recent lifting of Section 232 steel and aluminum tariffs on Mexico.

Manufacturers across a variety of industries increasingly view Mexico as a haven to insulate themselves from current and future trade disputes. A growing number have already begun shifting operations south of the border to avoid tariffs on Chinese goods.

For example, GoPro, the US camera maker, announced in May 2019 that it will be shifting production of US-bound goods from China to Guadalajara. The plant began shipments in June 2019. It's not just US manufacturers making the move: in the same month that the new GoPro lines started humming, Fuling Global Inc.—a Chinese producer of paper and plastic disposables—began shipments to the US from its new plant in Monterrey. As manufacturers move more production capacity over to Mexico, we expect to see longer-term growth in Mexico's share of US imports relative to Asian exporters.

Trade Policies' Negative Impact on US Manufacturers

US manufacturing gross output (MGO) did show strong 6.1 percent YoY growth in 2018, though it still lagged behind LCC import growth. This builds on 2017's positive swing out of 2016's manufacturing downturn (with 5.7 percent growth for 2017 over 2016).

Strong economic fundamentals at home—low unemployment and robust consumer spending—buoyed 2018's MGO. Growth is also credited, in part, to the stimulus provided by the Tax Cuts and Jobs Act of 2017 (TCJA), which went into effect January 1, 2018. The TCJA provides steep cuts to corporate tax rates, allows manufacturers to immediately deduct 100 percent of capital expenditures, and modestly increases disposable income for most consumers.³

Yet 2018's MGO growth happened against a volatile backdrop of shifting trade policies. What was the impact of all these tariffs, and counter-tariffs, on US manufacturing? **If the emerging trade wars had never begun, would US MGO have grown even faster?**

One clear indicator of the negative impact of trade policies is the **marked reduction in US exports** for those goods that are touched by the tariffs. As the US–China dispute kicked off on July 6, 2018, US exports to China took a 180-degree turn, shifting from 9 percent YoY growth in Q2 of 2018 to -9 percent YoY growth in Q3 2018.

Goods affected by China's first round of retaliatory tariffs were already on a downward trajectory from 2017 levels, and **growth nose-dived to -59 percent between Q3 2017 and Q3 2018**, a loss of \$3.5 billion in export value.

Q4 2018 saw an even steeper decline of 81 percent from the same period in the prior year, equivalent to a loss of \$8.6 billion in export value. By comparison, non-impacted goods grew by approximately 6,500 bps above impacted goods in Q3 and Q4. This differential between impacted and non-impacted goods narrowed in Q1 2019 to 1,300 bps as China put into effect a "good faith" suspension of its retaliatory tariffs on vehicles and some auto parts (see figure 4 on page 9).

The impact of tariffs on US manufacturers becomes clear when one considers companies such as Ford. In its 2018 annual report, the automaker identified \$750 million of tariff-related profit loss due to increased input costs and resultant higher prices, which slowed sales. Ford cites the tariff impact as one of the top contributors to its \$450 million YoY decline in earnings before interest and taxes (EBIT) for its North America automotive division, and for a loss of \$1.8 billion in its China operations. It is moving to contain its losses, announcing plans in May 2019 to reduce its workforce by 10 percent by Q3 2019.

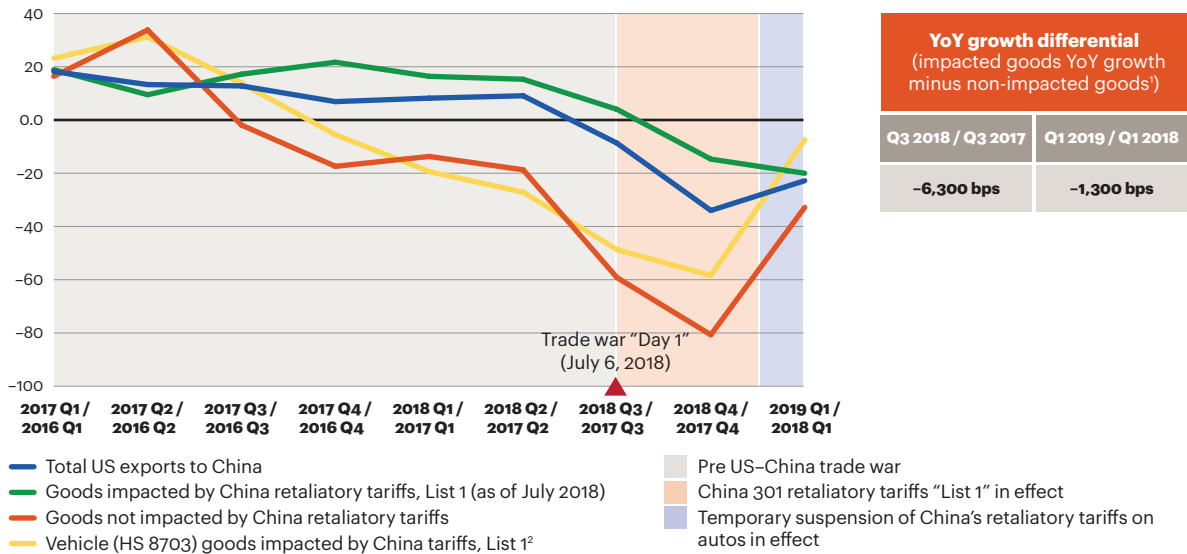
Ford is hardly alone in its troubles. General Motors, citing a challenging economic outlook—including uncertainty around trade policy—moved to lay off more than 17,000 hourly workers in October 2018, and has continued with layoffs of more than 4,000 salaried positions in Q1 2019. Harley Davidson responded to the EU's retaliatory tariffs on motorcycles by shifting production of EU-bound exports to its international facilities in Thailand. So, while intending to increase the number of manufacturing jobs, America's recent trade policy is, at least for now, having quite the opposite effect.

Nor does that policy seem likely to shift over the next year. In parallel to the deepening divide with China, the administration has threatened to impose tariffs on auto imports from Europe and Japan. This measure would amount to a declaration of trade war on countries such as

³ The TCJA expands first-year bonus depreciation for capital expenditures from 50 percent to 100 percent.

Figure 4
The trade war with China has had a sizable impact

YoY change in US domestic export value to China
 (2017 Q1–2019 Q1)



¹ Difference in bps between orange and green lines
² 8703 subheadings 23, 24, 33, 40, 50, 60, 70, 80, 90
 Sources: United States International Trade Commission; A.T. Kearney analysis

Germany and Japan, whose auto industries are of high strategic importance. Should this come to pass, Japan and the EU are sure to reciprocate in kind, placing further pressure on US autoworkers’ jobs.

Amid this uncertainty, CEOs are becoming more conservative with investments and more aggressive with cost-cutting initiatives. US manufacturers are more likely than ever to orient supply chains to those LCCs most insulated from trade disputes.

That same uncertainty extends to foreign investors as well. While the United States maintained its first-place showing in the A.T. Kearney 2019 FDI Confidence Index, its lead over the number-two country, Canada, is shrinking.⁴ The report notes that there are countervailing policy initiatives affecting FDI inbound to the United States.

US Labor Market Not Yet Ready to Support Broad-Based Reshoring

One of the conditions that needs to be in place to incentivize reshoring is the presence of a stable and predictable business environment that enables companies to deliver their products freely to the end-markets of their choice. The US has taken a step backward on this front, as the discussion above indicates. But leaving trade wars aside for a moment, what else is needed for manufacturers to start bringing jobs home at a significant rate?

⁴ The A.T. Kearney Foreign Direct Investment (FDI) Confidence Index® is an annual survey of global business executives that ranks markets that are likely to attract the most investment in the next three years.

Chief among manufacturers' needs is a robust labor force available at an attractive cost and composed of the right percentage of skilled workers. Last year's 2017 Reshoring Index report commented on the continued lack of skilled labor as one of the top constraints on the growth of US-based manufacturing. In this year's report we revisited the numbers, and the story did not change.

In 2018, the vacancy rate in manufacturing jobs grew for a fifth consecutive year. On average throughout the year, there were nearly half a million (466,000) vacant positions. The vacancy rate increased by 48 bps—a rate twice as high as the average for the preceding four years—from an average of 3.1 percent in 2017 to 3.6 percent in 2018. The shortage was most acute for high-skilled machine operator positions, as well as for managers. Vacancy rates grew even as the average rate of separations related to retirement or death decreased in 2018 from an average of 19 percent over the prior five years to 17 percent in 2018.

Addressing workforce shortages is essential if reshoring is to pick up momentum. As the nature of the situation remains unchanged from 2017, the path forward remains the same: manufacturers should undertake private–public partnerships to build talent pipelines and invest in up-skilling and re-training. Diversity and inclusion efforts, which could increase the pool of candidates willing to consider jobs in manufacturing, should be a focus as well. Advocating for increased immigration of workers able to fill crucial skills gaps will help address shortages in the near to medium term. But on this front, too, the current administration's policies are not helping.

Outlook for US Manufacturing Gross Output and Reshoring

Two dimensions will be most influential in shaping the future of US manufacturing and the prospects for reshoring: the level of **escalation or de-escalation of the US trade conflicts**, and the level of **investment in increasing US competitiveness** as it relates to labor, innovation, and US attractiveness to investors.

We have seen how trade wars act as a double-edged sword, creating winners and losers among both US and Chinese companies, as well as among other countries. On the other hand, every effort made to expand US competitiveness—labor re-training, capital-investment tax incentives, and investments to grow research and development (R&D) corridors—will contribute to driving a sustainable expansion of US manufacturing output and high-quality manufacturing employment.

Two possible paths

We foresee two possible paths the US could take when it comes to the trade conflict dimension: One path may be referred to as “All-Out Trade War,” while the other could be called “Compromise and Reconciliation.” In an All-Out Trade War scenario, the US would plow ahead on an escalating trajectory, with 25 percent tariffs expanded to all Chinese imports. We would also see a 25 percent tariff levied on EU and Japanese auto imports. Further retaliation by trading partners would be certain, coming in the form of equivalent tariffs on US manufactured and agricultural exports.

Such a trade war would not stop there; the administration's proposals to weaken the US dollar against other currencies and moves such as the Department of Commerce's May 2019 proposal to allow US companies to seek anti-subsidy tariffs on countries with undervalued currencies—a list that initially included Vietnam on its “watch list” before the country was subsequently removed from it—provide clear signals that the US trade wars have not yet reached their full scope.⁵

So what would be the results of an All-Out Trade War? US manufacturing gross output could continue its recent downward trend. A linear extrapolation of this trend (MGO contracted by an average of 0.4 percent between January and April of 2019) would suggest a decrease in MGO of up to 1.5 percent YoY by the end of 2019. This would bring the US into conditions most closely resembling the manufacturing contraction of 2016.

To be sure, decreased MGO would be a product of softened domestic demand as well as reduced export volume. Domestically, we have already seen 3 percent price increases on those categories of goods impacted by 2018 tariffs. The US's final tranche of tariffs on China would further aggravate pricing pressure, as more than 50 percent of goods impacted would be direct consumer goods, whereas earlier waves of tariffs were intentionally structured to focus on capital and intermediate goods. Resulting price increases—some economists project upwards of 8 percent—would in turn stymie consumer spending and further weaken business confidence.

On the export side, we would see continued and material reductions on par with the 60 percent and 80 percent declines in YoY export value of US exports to China for tariff-impacted goods (see figure 4 on page 9). On the EU and Japan front, retaliatory tariffs on US vehicles and parts, for example, could lead to an additional \$6.5 billion in lost US export value.⁶ In response to contracted demand, US manufacturers will move to trim costs, leading to reductions in force across US plants and dimming any prospects of a reshoring revival.

As US domestic demand and exports soften, imports from the 14 low-cost trading partners would continue to contract as well, likely at a faster pace than falling US MGO, as has been the case in Q1 of 2019. In this scenario, the Reshoring Index could improve as imports are curtailed faster than US MGO contracts. However, such an improvement in the Index would reflect little more than a “race to the bottom” dynamic, and would hardly be cause for celebration.

What's the alternative? Our Compromise and Reconciliation scenario would see an agreement between the United States and China, addressing American complaints on Chinese subsidies for domestic companies and IP protection violations. The USMCA—including key Mexican concessions on auto production and auto worker wages—would be ratified. The US might even win some victories as it winds down the trade wars; trading partners could agree to voluntary import expansions for US goods, as well as reforms to anti-competitive trading practices.

For US manufacturers, a climb-down from the new tariff regimes would reverse recent declines in US exports for impacted goods, and alleviate inflationary pressure on US consumer products. Manufacturing gross output would recover from the Q1 slump and grow YoY in 2019—likely in the low single digits. In this scenario, the Reshoring Index would continue its current trajectory of low double-digit declines YoY as import growth recovers slightly ahead of US MGO.

⁵ Federal Register RIN 0625-AB16: “Modification of Regulations Regarding Benefit and Specificity in Countervailing Duty Proceedings”

⁶ Scenario assumes EU and Japan impose tariffs on HTS section 87 goods and the US experiences a similar YoY reduction to export value as seen in its section 87 exports to China following China List-1 retaliatory tariffs.

Level of investment in US competitiveness

Given the recent trajectory, with each week's news unveiling new tariffs and new tensions, or temporary cease-fires, both trade war scenarios have about the same likelihood of occurring. Regardless of which path the US follows on trade, though, investments in US competitiveness should remain core to the policy agenda. These **investments should prioritize three areas:** (1) labor, (2) innovation, and (3) foreign direct investment.

On the labor front, the policy agenda—as discussed earlier in this paper—should concentrate on increasing the availability of manufacturing workers; emphasis is required on growing the pool of skilled workers capable of working on production lines using increased levels of automation and technology assistance.

On the innovation front, policy should focus on maintaining or growing current federal expenditures on R&D and advancing public-private partnerships to build and sustain innovation ecosystems such as Manufacturing USA. Innovation is essential to keeping the US at the forefront of manufacturing techniques, which in turn will allow manufacturers to grow share within high-value-add production segments and expand manufacturing employment for higher-skilled and higher-paid positions.

US investments in labor and innovation directly advance the goal of increasing foreign direct investment in the manufacturing sector. The US benefits from the highest levels of FDI (\$275 billion in 2017) compared to all other countries, and—as discussed in A.T. Kearney's 2019 FDI Confidence Index (FDICI)—has ranked number 1 for the past seven years as the most attractive destination for foreign investment.

The strength of America's FDI position rests largely in the size and strength of the domestic market, as well as the stability and transparency of its institutions and policies, though the current conflict may be reducing confidence in this latter factor. Continuing to cultivate the US as a desirable place for foreign manufacturers to invest can only benefit American output and employment levels.

A policy agenda that accelerates investments in US competitiveness, as described above, will translate into improvements in the Reshoring Index, independent of whichever path is taken on trade.

Conclusion

2018 saw the Reshoring Index decline by 32 bps, confirming for a fifth consecutive year that the long-established economics of offshore production continue to outweigh the benefits of manufacturing at home. All else being equal, we would expect a continuation of this trend going forward, though with a greater percentage of offshore production of goods for the US market coming from non-China LCCs as well as Mexico.

That said, we can predict that 2019's Reshoring Index will be profoundly shaped by the maturation of the trade conflicts that have sprung up in all corners of the world over the past three quarters. In the worst-case scenario, trade wars will escalate, and the administration will fail to make the required investments to bolster US competitiveness and attractiveness. We may see some reshoring in this case, but this benefit will come at the expense of a contracting domestic and global economy.

Beyond reshoring, though, the overarching US policy objective should be to bolster US manufacturing competitiveness for those high-value sectors where onshore production does make sense. In the best-case scenario, prioritization of this agenda will be paired with a wind-down of tensions with China, the EU, and others. This future is plausible but requires the support of American policy makers and industry leaders to contain and reverse recent tariffs, and to focus the federal budget toward the right domestic priorities.

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About the A.T. Kearney US Reshoring Index

When we launched the Reshoring Index in 2014, much of the evidence for reshoring was anecdotal, often highlighting no more than a handful of high-profile cases, and the conclusions seemed to reflect wishful thinking or political agendas more than hard facts. Even the best research focused more on promulgating models of future reshoring than on accurately assessing the current reality. So our objectives were simple: (1) find out what US manufacturers were doing, and (2) separate the reality from the hype. The A.T. Kearney US Reshoring Index addresses these objectives by aggregating actual US manufacturing and import data to track what is really happening, while providing a simple but powerful indicator of where manufacturing for the United States market is going.



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Bogotá	Detroit	São Paulo
Boston	Houston	Toronto
Calgary	Mexico City	Washington, D.C.
Chicago	New York	

Asia Pacific

Bangalore	Kuala Lumpur	Shanghai
Bangkok	Melbourne	Singapore
Beijing	Mumbai	Sydney
Brisbane	New Delhi	Tokyo
Hong Kong	Perth	
Jakarta	Seoul	

Europe

Amsterdam	Ljubljana	Paris
Berlin	London	Prague
Brussels	Madrid	Rome
Bucharest	Milan	Stockholm
Copenhagen	Moscow	Vienna
Düsseldorf	Munich	Warsaw
Lisbon	Oslo	Zurich

**Middle East
and Africa**

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Doha	Istanbul	Riyadh

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The signature of our namesake and founder, Andrew Thomas Kearney, on the cover of this document represents our pledge to live the values he instilled in our firm and uphold his commitment to ensuring “essential rightness” in all that we do.

A.T. Kearney Korea LLC is a separate and independent legal entity operating under the A.T. Kearney name in Korea.

A.T. Kearney operates in India as A.T. Kearney Limited (Branch Office), a branch office of A.T. Kearney Limited, a company organized under the laws of England and Wales.

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