

Adviser Soapbox

Bring Back American Jobs And Technology

Carlton Delfeld, 08.10.05, 11:53 AM ET

During the last decade, a hot topic in Japan and America has been the "hollowing out" of their industrial bases. The share of Japanese-owned productive capacity located abroad has grown from 8% in 1994, to 40% today. The United States currently has just over 50% of its manufacturing base located offshore.

For both Japan and America, the large outflows of direct investment, especially to China, have caused an uneasy feeling that both countries had bleak futures as manufacturing centers.

Surprisingly, in Japan, the pendulum is now swinging back as large Japanese multinational corporations are busy investing in manufacturing plants at home. Here are just a few examples of this trend. **Canon** (nyse: [CAJ](#) - news - people) is building a large digital camera facility and plans to spend 80% of its \$7.2 billion capital budget in Japan over the next three years. This is a reversal from the past ten years, when 80% of its capital budget was spent overseas. **Toshiba** is building a \$2 billion semiconductor facility. **Sharp**, **Matsushita** and **Nippon Steel** are also building major plants in Japan. Overall, spending on plants and equipment in Japan is rising at a 10% clip.

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It's not that China is not important to Japan's economic growth. China has passed America to become Japan's largest export market. In addition, it needs a strong presence in China to tap its rapidly growing consumer market as well as a low cost base to manufacture lower tech products. For certain products such as cars, it is also likely to keep large manufacturing bases in countries like the U.S.

For example, **Toyota Motor** (nyse: [TM](#) - news - people) produces more than 1 million cars annually at eight manufacturing plants in America and has two plants under construction in Texas and Tennessee. But for the more advanced capital-intensive products, the investment is clearly coming home.

How can we account for this surprising turnaround and what are the lessons for America? First, Japanese firms have learned the drawbacks of outsourcing: supply bottlenecks, poor infrastructure, power shortages, uneven quality, difficult inventory management and high employee turnover to name a few.

Secondly, even though China's wages are about 5% of Japan's, its increasingly sophisticated factory automation has lessened the importance of labor costs. For advanced high tech products it accounts for only 10% to 15% of total costs. Having manufacturing closer to home also shortens new product lead times and increases cooperation between R&D and production team, leading to a crucial edge in staying ahead of nimble competitors. Supply lines of 2,000 miles can be problematic.

Lastly, and perhaps most importantly, there is the critical issue of protecting intellectual capital. Having research, development and production closer to headquarters better protects proprietary technologies.

Unfortunately, here in America the outsourcing trend does not appear to be reversing, even in capital-intensive products. Many of the new high tech jobs are for managers to manage the outsourcing process. **Microsoft** (nasdaq: [MSFT](#) - [news](#) - [people](#)), **Intel** (nasdaq: [INTC](#) - [news](#) - [people](#)), **IBM** (nyse: [IBM](#) - [news](#) - [people](#)) and **Motorola** (nyse: [MOT](#) - [news](#) - [people](#)) all have large and growing R&D centers in China to take advantage of Beijing's cheaper pool of talent.

Given China's disregard for intellectual property rights, perhaps American executives should pause and reconsider the long-term costs of growing outsourcing programs. Their offshore R&D staff may very well walk off with proprietary knowledge and the company's future.

Many Americans believe the loss of manufacturing jobs is just about lower wage rates in other countries, but this is not always the case. One example is **Whirlpool** (nyse: [WHR](#) - [news](#) - [people](#)), which makes its high-end front loading washing machines in Germany (\$32/hour labor) and ships them to the U.S. (\$23/hour labor). The reasons given by Whirlpool: a trained German workforce, available capacity and necessary technology. Whirlpool could have produced these washing machines at their Ohio plant and saved the \$50 per unit shipping costs, while creating high-wage American jobs.

Then there is America's growing annual trade deficit that exceeds \$600 billion a year with \$200 billion attributable to our trade gap with China. You have to admit that it is harder to make a strong case against Chinese trading practices when 40% or more of American imports from China come from American multinationals with China-based manufacturing plants.

Why not sell more of the stuff we make in China to China's 1.3 billion consumers? If these markets are not open to American companies, let's use the leverage of access to America's vast consumer market to bust them open.

There are some economists and policymakers who claim a strong manufacturing base is not important. I beg to disagree. History shows that manufacturing is the foundation of all wealth and that research and development follows manufacturing rather than the other way around. There are now more American workers in state and local government than in the manufacturing sector, and manufacturing as a percentage of GDP has fallen from 20% in 1980 to less than 10% today.

This is not a call for isolationism or rolling back globalization, just a reminder that outsourcing has its downside. How about a little common sense and balancing short-term cost savings against long-term strategic risks?

Instead of just taking the comparatively easy step of lowering labor costs by outsourcing, let's roll up our sleeves like the Japanese, improve manufacturing techniques and reap the benefits of keeping more production and technology closer to home.

*Carlton Delfeld is head of the global advisory firm Chartwell Partners and editor of [The Chartwell Advisor](#) and the Asia Investor Intelligence newsletters. He served as a director on the executive board of the Asian Development Bank during the Administration of President **George H. W. Bush**, and he is the author of *The New Global Investor*. [Click here for more analysis from Delfeld](#) or to subscribe to [The Chartwell Advisor](#).*