US Manufacturing Sector Structural Cost Disadvantage Shrinks, but Still is over 17% Versus Major Global Competitors on Average, NAM Report Says

Rapidly Rising Labor Costs in Mexico, China and South Korea Reduce Their Advantage; Other Countries are Lowering Manufacturing Tax Rates to Help Their Producers

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Every few years, the National Association of Manufacturers (NAM), The Manufacturing Institute, and The Manufacturing Alliance jointly release a study on US manufacturing cost competitiveness versus a variety of other countries.

The third and most recent report (**The Tide Is Turning: An Update on Structural Cost Pressures Facing U.S. Manufacturers**) has just been released, and provides a "good news/bad news" analysis of US manufacturing competitiveness. To download the full report, go to: The Tide Is Turning.

The good news: the gap between the US and major global competitors in terms of cost infrastructure has shrunk from the last study, performed in 2006. The bad news, the gap is still substantial, placing a high burden on US manufacturers, the report says.

"The disadvantage that U.S. manufacturers face is 17.6 percent when compared with nine major industrial countries including Germany, Japan, Canada, Mexico, and China," the report says. "This is still a substantial hurdle that cuts into the competitiveness of American businesses that operate in a global market. But it is an improvement from the 31.7 percent gap that we reported on in 2006." (The comparison countries are Canada, the UK, Mexico, Germany, France, Japan, South Korea, China and Taiwan.)

That gap requires some further explanation, however. As shown in the chart on Page 2, the US actually has a structural cost advantage against many of the comparison countries, including Germany, the UK, France and Canada. But it has a much, much higher structural cost than China, Mexico and Taiwan, bringing the total average for the nine other countries way down. (Note the "raw cost" is a measure of wages and productivity for a given country. The data are in a home country's currency, and thus do not consider the global impact of relative currency valuations, meaning the fall of the US dollar until just recently would have had the effect of lowering the cost gap with most other countries or expanded the US advantage in other cases.)

The reduced gap in the delta between US structural costs and major competitors is coming from a combination of progress in the US in some cost areas and rising costs in other countries in others.

The report notes the US is still the world's largest manufacturer, and produces about 20% of all global manufacturing output. Perhaps surprising to some, exports have fueled a considerable amount of US manufacturing growth. Exports have grown by 70% since 2001, and represent a startling two-thirds of the growth of US GPD.

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For example, the report notes that health care cost increases have moderated a bit in the US, there

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Effect of Key "Overhead Costs" on Raw Cost Index of Nine Largest U.S. Trading Partners, 2007
(U.S. dollars)

	United States	Average of nine partners	Canada	Mexico	Japan	China	Germany	United Kingdom	Korea	Taiwan	France
Raw cost index	29.83	27.63	35.61	23.37	25.81	12.41	32.96	44.43	31.45	22.13	35.49
Corporate tax rate	--	-7.8	-3.9	-12	0.7	-15	-1.6	-10	-12.6	-15	-6.7
Employee benefits	--	-3.6	-2.2	-11.1	-4.1	-3.9	1.1	-0.6	-4.9	-9.3	10.1
Tort costs	--	-2.8	-2.9	N/A	-3.1	N/A	-0.5	N/A	N/A	N/A	-1.1
Natural gas costs	--	0.9	-0.1	0.4	1.5	N/A	1.7	3.3	4.3	-1.2	1.6
Pollution abatement	--	-1.8	-0.7	-3.3	-0.7	N/A	-0.2	-2.7	-0.5	N/A	-0.2
Effective cost index	29.83	23.50	32.11	16.55	24.37	9.25	33.11	38.60	26.14	15.02	36.81

Source: Author's calculations based on data in subsequent tables and figures

Note: Data for tort costs and regulatory compliance costs are limited to the industrialized partners. Conservative assumptions have been made in estimating the missing values, as described in later sections. Thus, the absence of these data likely understates the overall cost advantage of U.S. trading partners.

Source: "The Tide is Turning" Manufacturing Report

has been progress made in tort reform, regulatory costs, and pensions costs, the latter of which are declining as more companies move to 401ks and other "defined contribution" plans versus pensions.

Conversely, social benefit spending and environmental/regulatory costs are rising in many of the other countries, including China, the report says, as well as raw structural costs. Those costs doubled Mexico since from 2002 to 2006, for example, which may seem almost impossible, but is true, the report says.

This "illustrates a common pattern in economies in the later phases of industrial development: After a period of falling unit labor costs driven by capital investment, wages eventually start to increase faster than productivity, which perforce leads to rising unit labor costs," the report notes. "In Mexico, hourly direct pay has increased by 55 percent since 2000, but productivity by only 27 percent. Recent examination of trends in China reveals that it too has seen wage growth well in excess of labor productivity growth." Korea has also seen rapid wage inflation.

Taxes and Energy

The report finds the most burden is in the US corporate tax rate; it also found the previous US advantage in energy costs is shrinking.

"High corporate tax rates continue to be the single most significant drag on manufacturing cost competitiveness," the report says. It adds that while the US has kept manufacturing taxes steady, many other countries have lowered them in recent years to give strength to their producers. It goes on to forecast that a cut in the corporate tax rate of 5% would lead to the creation of 500,000 US manufacturing jobs.

On energy, the report says that government policies have kept the US from fully leveraging its advantages in natural gas supplies, and that as a result the US energy advantage is shrinking over other countries.

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"It is important to realize that a decade ago the United States enjoyed energy prices on the order of 30 percent lower on average than its major trading partners, implying a cost advantage of more than double that of today,' the report says.

The report concludes by noting that the US should not rely on a falling dollar to drive global competitiveness and exports – a conclusion especially pertinent now given the steep run up in the dollar of late, after several years of decline.

"Further leveling the playing field with regard to structural costs will allow U.S. manufacturers to compete and win in the global economy irrespective of the vagaries of currency exchange rates," the report says.