The Huffington Post

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It Takes More than Economics 101 to Compete With China

Posted: 10/24/2013 3:48 pm

We have heard a great deal this year about manufacturing coming back to the United States. We hear about the diminishing wage gap in some Asian countries and the possibility of lower U.S. energy prices. In addition, a few small examples of goods currently made in China, but now being planned for U.S. manufacture, are pointed to as a harbinger of great things to come.

Yet these discussions, as well as the reports and studies they often cite, are almost always purely economic cost analyses. They estimate future wages here and abroad, worker productivity and transportation costs, and they conclude that the manufacturing differences between the United States and Asia are diminishing. They then extrapolate these trends far enough into the future that going to Asia seems no longer worth the trip.

Non-market factors are given at most a minimal mention in many arguments that favor reshoring, as it is called, of Chinese manufactured goods. But China's exchange rates, as we know, are set by its government, not by markets. The massive government subsidies of land, energy and technology, in addition to low- or no-cost loans, are barely mentioned. These are, however, the levers that have catapulted Chinese industries into global prominence in a very short span of years. And these government actions are not going away; if anything, they are increasing.

Americans are assured, based on flawed analysis, that when U.S. companies find it cheaper to make certain goods domestically, they will do so. What is overlooked in reaching that much-wished-for conclusion is that the Chinese, following the example of other Asian nations, simply do not allow important outcomes to be determined in that way.

China did not get to where it is today by allowing natural economic forces to decide the outcome. The reality is much closer to the exact opposite. An industry is targeted, and then the economic forces needed to obtain a dominant position -- including subsidies, special tax rates, exchange rates and technology agreements -- are put in place. This fundamental reality cannot be ignored.

One report I am particularly fond of, from the respected Boston Consulting Group, is powerfully titled "Made in America, Again." The cover is a pleasure for any patriot to see: It is simply a large red, white and blue American flag with small figures unrolling the red stripes, while others check the stripes' exact locations before fixing them into place. The cover graphically and dramatically suggests the glorious return of U.S. manufacturing.

However, what is inside the report is much less colorful but far more realistic. It concludes that if the United States maintains a "flexible" labor force and a good investment climate, it will become "increasingly attractive" for those who want to stop manufacturing goods in China that are consumed in the United States -- attractive, that is, for those who, for one reason or another, find other countries in Southeast Asia unattractive.

This is the feeble manufacturing renaissance promised in the report. To get to this rather wishy-washy conclusion, all sorts of leaps of faith are required both in this specific report and in many similar analyses. One must accept that there will be double-digit yearly increases in Chinese wages. One must accept that American workers will remain more productive than Chinese workers. One must be willing to equate U.S. subsidies -- few and far between and tiny as they are -- with those employed by the Chinese government. And one must believe that the relatively few small manufacturing plants planning to move back to the United States show that forces are in place to close a yearly manufacturing trade gap measured today in the hundreds of billions of dollars.

But most of all, despite the evidence of recent history, there is a tacit assumption that the Chinese government would simply stand by and let these happy outcomes happen. This is unlikely; the Chinese government does not share our pure and simple faith in the unguided operation of markets.

That China adheres to its system is not surprising; its system has been working for it. What is more surprising is that our faith in our own system is so ingrained that we continue to believe in its benign results even in the absence of the free markets and free trade conditions on which those conclusions are based.

A real manufacturing renaissance in America -- at least one based on reshoring from China -- is not something we can expect. Forecasts that reach that much-desired conclusion by simply extrapolating cost analyses into the future are not realistic. There is far too much that China and other countries can do to shape the outcome. We would do better to consider what we can realistically do in today's mercantilist world rather than continue to act as if we were living in a textbook world, a world shaped only by market forces.

*A version of this blog was first published under a different title by the Metals Service Center Institute