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RE-SHORING IN EUROPE: TRENDS AND POLICY ISSUES

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Re-shoring is currently a highly debated issue in many European economies, (e.g. Germany and the United Kingdom).[1] One principal reason for this interest is that re-shoring is perceived as a potential source of renewed job creation—particularly in hard hit sectors such as manufacturing, which have been the most exposed to offshoring activities. This note aims at providing a better understanding of the re-shoring phenomenon based on both proxy data and existing literature. It then discusses the implications for labour markets and examines key policy challenges.

WHAT IS RE-SHORING AND WHY IS IT HAPPENING?

Re-shoring is defined as the relocation of all or parts of the production process to (or near) the country of origin of the parent company by a multinational enterprise (MNE). The term re-shoring comprises two components: i) near-shoring, i.e. if production is relocated to a location near the home country (e.g. to Canada instead of the United States or to Eastern Europe instead of Germany); ii) back-shoring, i.e. if the production is relocated to the same country. The relocation of production can be done either by shifting production completely to suppliers in the home country or diminishing investment abroad and investing in the home country.

MNEs pursue re-shoring for a number of different reasons only some of which are relocated to cost consideration. Indeed, the primary reason for offshoring is related to costs, in particular lower labour costs than in the home countries. However, once installed, MNEs can discover the presence of other factors that may impact negatively on the production process such as poor performance of foreign firms, lack of infrastructure, risks related to supply chains such as uncertain delivery times and political instability in the country.[2]

Rising costs related to labour and market trends do lead some MNEs to reconsider offshoring decisions. For example, wage costs in some developing countries that have been principal destinations for global supply chains (GSCs), have increased in the past decade, making offshoring less cost-effective. It is estimated that wages in China have risen from 15 to 20 per cent on average per year between 2000 and 2010.[3] Rising transport costs due to high oil prices over the last decade and increased volumes are also a factor in the re-shoring decision.[4]

[1] (Bailey and Propris 2014).

[2] See for example (Dachs and Zanker 2015; Bailey and Propris 2014; Ellram, Tate, and Petersen 2013; Kinkel 2012).

[3] (BCG, 2011).

[4] However, as oil prices are currently very low this might have a negative impact on re-shoring.

However, cost is not the only factor impacting re-shoring. The search by consumers (and therefore companies) for better quality and personalized products is an important incentive. Customers are increasingly looking for better quality and originality, and are interested in less standardized and more personalized products. Thus, companies engaged in offshoring also search for improved quality.[5] Additionally, public awareness is more heightened with respect to labour standards in supplier companies abroad and environmental consequences of international production. Thus, there is a drive for more local manufacturing. Finally, weakened demand prospects in some foreign markets have been another factor for firms servicing the local markets (for example the case of Nestlé in Africa[6]).

These changing demand and cost structures are important factors in MNEs production strategies. They can result in decisions such as co-locating certain activities (R&D and production) or shortening the supply chains to ensure efficiency and quality.

WHAT IS THE EVIDENCE FOR RE-SHORING?

Re-shoring is a difficult phenomenon to measure both at the aggregate and firm level. The difficulties stem especially from the fact that it is challenging to attribute changes in investment and employment trends directly to re-shoring. Indeed there are individual accounts of re-shoring in the media for specific companies, but in general the phenomenon is difficult to assess.[7] Firstly, the rationale behind the closure of a plant abroad or reduction in foreign direct investment (FDI) by an MNE is not clear-cut. Additionally, data at the plant level are not always publicly available and research on re-shoring is nascent with a limited number of analyses available. What follows is an attempt to provide an overview of the extent of this phenomenon by examining both aggregate data at the macro level and firm-based data at the micro level.

Trends in international trade

The macro level evidence on re-shoring could be linked to trade, employment and investment flows. Since re-shoring is the relocation of previously off-shored or outsourced activities back to the home country (or a closer country) data on international trade – and especially on the international fragmentation of production - might give an initial insight into this phenomenon.

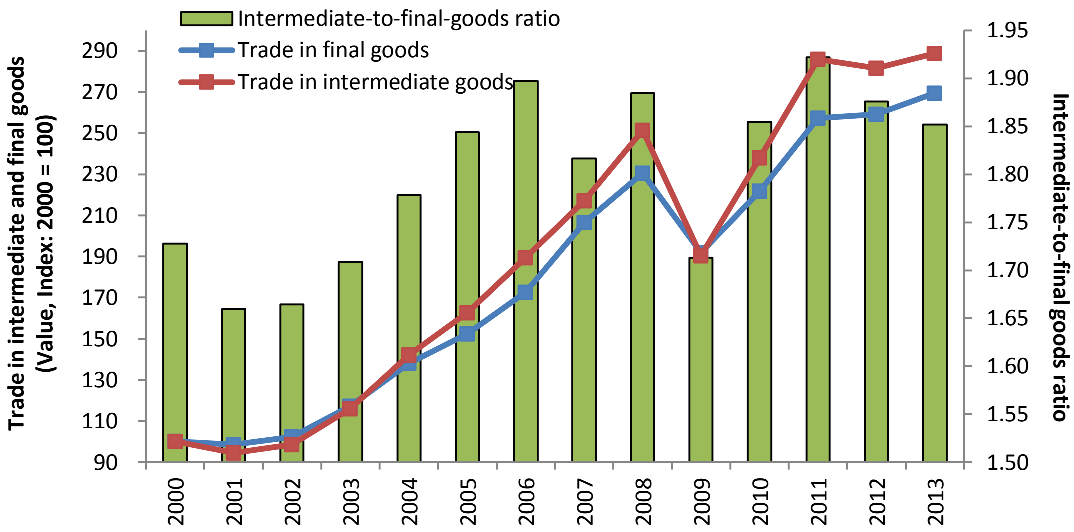
Figure 1 shows trade in intermediate and final goods pre- and post- crisis. Trade in intermediate goods is particularly relevant for grasping the extent of the trends in the international fragmentation of production. Increasingly more stages of the production process are being undertaken across borders, which has led *particularly* to an increase in trade in intermediate goods. Thus, the decline observed in trade in intermediate goods in recent years might be an indication of both a slowdown in offshoring and existing re-shoring.

[5] Almost all studies based on firm-level surveys agree that lower than expected quality of the goods produced abroad is the principal reason for re-shoring.

[6] http://www.ft.com/intl/cms/s/0/3ff4f250-1b4a-11e5-8201-cbdb03d71480.html?siteedition=intl#axzz3mNHykyPQ

[7] Financial Times (http://www.ft.com/intl/cms/s/0/21a46546-78f1-11e1-88c5-00144feab49a.html?siteedition=intl#axzz3mNrAaPbT), and the Economist (http://www.economist.com/news/special-report/21569570-growing-number-american-companies-are-moving-their-manufacturing-back-united) concerning General Electric and Google. See

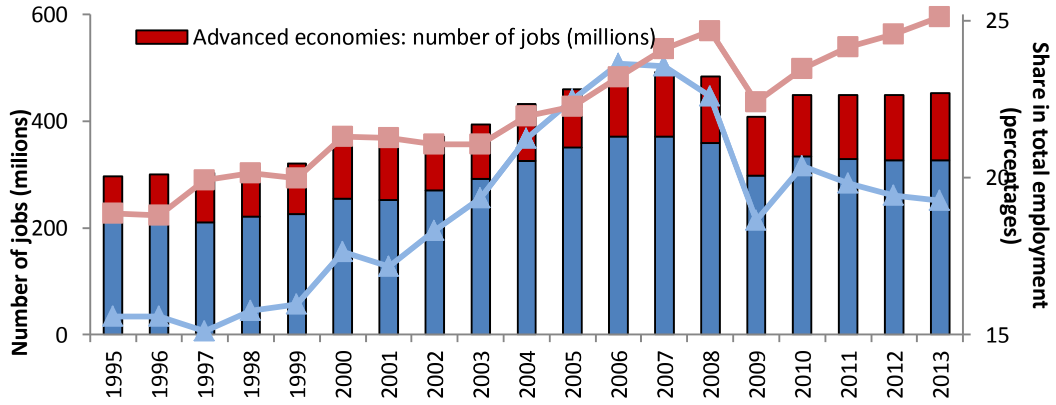
Figure 1: Trade in final and intermediate goods, 2000-2013



Source: ILO Research Department calculation based on OECD STAN database.

A similar pattern is observed for the number of jobs linked to GSCs. While such jobs increased considerably prior to the crisis, there has been a slowdown since 2008 (**Figure 2**). Indeed, the share of GSC-related jobs in emerging economies has declined in the last five years. This could be related to the slowdown in emerging economies and aversion of risk by MNEs, which could also be an indicator of re-shoring.

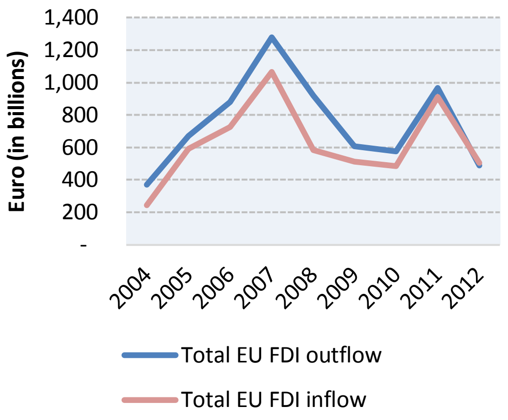
Figure 2: Number and share of jobs linked with GSCs, 40 countries (66% of the global labour force), 1995-2013



Source: ILO Research Department estimates based on WIOD.

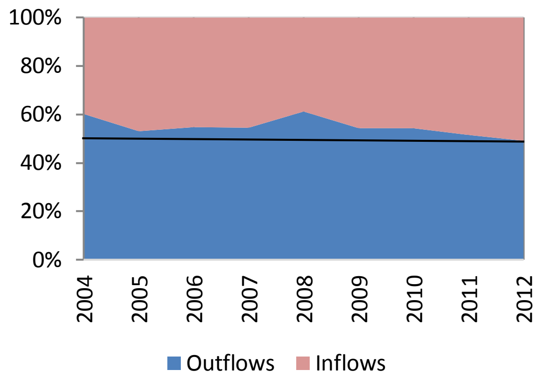
Slowdown in foreign direct investment (FDI) outflows

Figure 3: EU FDI flows by directions



Source: Eurostat Note: EU refers to EU-27 countries

Figure 4: Composition of EU FDI flows by directions, 2004-2012



A final way to consider re-shoring at the aggregate level is through data on FDI flows. Traditionally, Europe has invested abroad to a greater degree than "being invested" (**Figure 3**). In 2004, the share of FDI outflows in total FDI flows accounted for 60 per cent of total FDI flows (**Figure 4**). However, this trend has been shifting since 2008, when the share of FDI outflows started to diminish and that of inflows started to increase. Indeed, in 2012, FDI inflows and outflows accounted for about the same share in the total FDI flows. In this respect, it is not only the size of outflows that is decreasing, but also its share relative to inflows. This could be an argument in support of re-shoring.

It should be noted, however that FDI flows also comprise purely financial flows which are not related to real investment activities and are very high in some European countries (e.g. Luxembourg). The decline after 2007 might also be linked to financial flows and not necessarily related to re-shoring.

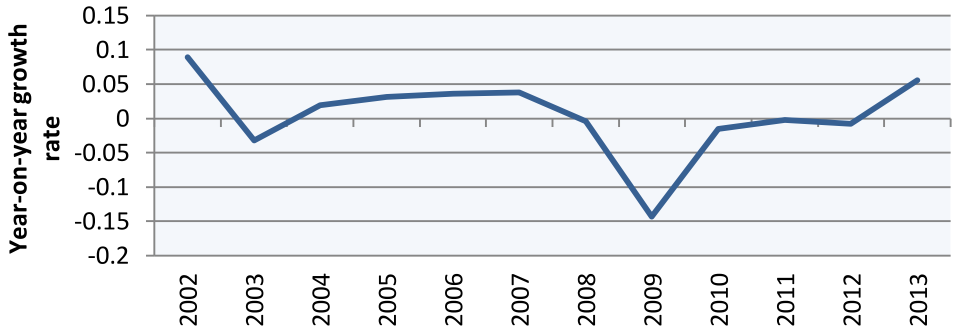
Firm-level data

Data at the firm level could help to support some of the findings at the aggregate level, particularly with respect to investment flows. Firm level data are available from the *Factset* database, which provides data for more than 70, 000 publicly listed firms from 100 countries. The first indicator analysed is the share of domestic assets to total assets, which is suggestive of the internalisation of the production in one country. This indicator has been increasing for the EU as a whole since 2009. In this regard, data at the firm level from *Factset* seem to support the hypothesis of re-shoring (**Figure 5**).[8] Although this could be an indication of a return to pre-crisis levels rather than re-shoring, when coupled with the reduction in FDI outflows it does suggest stronger domestic activity.

[8] The Factset database does not allow distinguishing between European and non-European countries in the definition of foreign assets. Thus, it is not clear if this increase reflects a possible re-shoring from developing and emerging countries or from other European countries, which would significantly impact the interpretation.

Other indicators at the country level are available in seminal studies. Bailey et al. (2015)[9] uses data from the Spanish *Encuesta Sobre Estrategias Empresariales* (ESEE) database (2007-2012), and takes as a measure of re-shoring "firms simultaneously experiencing an increase in domestic insourcing and a decrease in foreign outsourcing". The study concludes that while re-shoring seems to be a limited phenomenon in this country it is positive and probably under-estimated, as the indirect effects are not necessarily taken into consideration.

Figure 5: Share of domestic assets to total assets, 2002-2013



Source: ILO Research Department based on FactSet

Other indicators of re-shoring at the micro level, obtained directly from survey data, provide additional support for re-shoring. While there is no consensus, some general findings emerge from these surveys. R&D-intensive companies tend to re-shore more while firms producing standardized products are less likely to engage in re-shoring. Back-shoring is more frequent in high **technology sectors such as electrical equipment and computer industry** [10]and larger firms are more likely to re-shore.

- Based on *European Manufacturing Surveys*, Dachs and Zanker (2015) find that 4 per cent of surveyed firms back-shored (over 3000 surveyed) between 2010 and mid-2012. They also find that in the same period "[f]or every back-shoring firm, there [we]re more than three offshoring firms" [11]suggesting that this phenomenon cannot be the source of fundamental changes in Europe.
- In the UK, a survey conducted by Manufacturing Advisory Service (500 firms) reveals that in 2013 11 per cent of firms back-shored while 4 per cent offshored.[12] EEF (the Manufacturers' Organisation, UK) finds similar results with one in six manufacturers bringing back production to the UK between 2011 and 2014, which constitutes a slight increase from 2009. [13]
- Based on German data, Kinkel (2012) finds that 3 per cent of firms back-shored from 2006 to 2009 compared to the previous period (2004-2006). Additionally the study finds a smaller proportion of

[9] Presentation given at SASE Conference, 2015, London

[10] (Dachs and Zanker, 2015).

[11] (Dachs and Zanker 2015, 1).

[12] http://www.mas.businessgrowthservice.greatbusiness.gov.uk/news/mas-barometer-reveals-quality-cost-and-delivery-are-prime-drivers-to-move-production/

[13] (EEF 2014).

offshoring in the same period (9 per cent instead of 15 per cent), strengthening any possible impact of re-shoring.

IMPLICATIONS AND CHALLENGES OF RE-SHORING

Some argue that bringing back jobs to Europe might mean creating higher quality jobs with better protection. However, others believe that any jobs that return will not necessarily be the same as those that previously left. Some also question if re-shoring, in particular in manufacturing, is a realistic option since the necessary skills in many European countries have eroded due to intensive off-shoring in the last decades.

In terms of trade, bringing back manufacturing jobs to Europe might initially lead to an increase in exports in European countries along with a decrease in imports of both final and intermediate goods. However, exports from developing countries would decline, and incomes would fall in developing countries not only due to job destruction but also to the decline in tax revenues. Such changes might be accompanied by contagion impacts in developed economies.

This suggests that labour and social policies should aim at improving competitiveness. In this respect, countries ensure a level playing field and encourage off-shoring or re-shoring activities that are attracted to productive factors such as skills and quality orientation, rather than simply low labour costs.

Public policies can help in improving reliability of products and logistics by strengthening the overall infrastructure of the country, which includes roads, telecommunications and transportation systems, and workers' skills. In this regard, education and training activities are extremely relevant for achieving higher quality production. Such activities also result in increased productivity, which in return, can result in diminishing costs.

In addition, stable regulations to help guarantee a safe business environment are beneficial. In this context, a balanced tax system is important both to avoid discouraging investment decisions and to ensure that enough resources go to governments for a healthy functioning infrastructure.

More importantly, fostering production is only possible if there is sufficient demand to absorb it. This requires the presence of a large and stable middle class. Sound policies on minimum wage and unemployment benefits can prevent the vulnerable from falling into poverty, and help them smooth the transitory income shocks. On the contrary, long-lasting austerity measures, along with unequal distribution of income can undermine the maintenance of a sustainable demand. Increasing inequalities in a number of European countries means that a smaller share goes to those at the lower end of the income spectrum. Therefore policy-makers should pay particular attention to addressing inequalities in their effort to consolidating budgets.

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