

Nearshoring---Panacea, Quick Fix or Something in Between?

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Ever since the 2008-2009 global financial crisis, proponents of trade and investment liberalization have found themselves in the gun sights, metaphorically speaking, of both the left and the right. Globalization has been their piñata. Both Republicans and Democrats have adopted and inward-looking, populist orientation with corresponding policies, resulting in a real threat to free trade.

The worldwide pandemic itself has posed dire challenges to trade, investment and the operation of companies engaged in cross-border commerce. One such challenge that looms large is where to source.

Many large U.S. companies choose to insource (source within the firm) while others outsource to firms that specialize in the company's particular needs (e.g., information technology), and still others choose to offshore, especially to China, Taiwan and Korea.

But what do firms do when insourcing, outsourcing domestically, and offshoring are not feasible for reasons such as cost, speed of delivery, reliability, and control? Enter *nearshoring* the growing compromise of choice.

Nearshoring, simply stated, is the process of a firm locating all or part of its business operations closer to home or where its products are sold. It has always been available as a sourcing option but has gained greater prominence in global trade since the onset of the pandemic. According to Nobel laureate in economics A. Michael Spence, the confluence of easy monetary policy, elevated savings balances, pent-up demand and massive fiscal spending (leading to higher rates of inflation) has sparked shortages, backlogs and imbalances between supply and demand.¹ Fold in increasing political tensions between the U.S. and China and one can easily see why both importers and exporters seek to diminish their commercial risk by shortening the supply chain.

What are the benefits of nearshoring? For one it allows more frequent visits to the manufacturing site, better control of intellectual property, operating in a more convenient time zone, quicker transit from manufacturer to the customer, greater speed to market, improved quality control, and improved supply chain efficiency.²

Some successful nearshoring examples are Inditex, the Spanish apparel company and parent company of Zara, that has been moving production from Asia to Morocco and Turkey as well as Whirlpool, Samsung, LG and Boeing that now produce the majority of their products in Mexico.³ Nike and Hasbro reducing their presence in China in favor of Mexico is another example.

¹ <https://www.cfr.org/blog/why-are-supply-chains-blocked#:~:text=Because%20there%20is%20relatively%20little,and%20bottlenecks%2C%20like%20those%20today.&text=Supply%2Dchain%20disruptions%20are%20severely%20hampering%20the%20global%20economic%20recovery.>

² <https://blog.intekfreight-logistics.com/top-10-benefits-nearshoring>

³ <https://biz30.timedoctor.com/nearshoring-examples/>

Make no mistake, however. Nearshoring does have its limitations. Disadvantages include high expenses (labor, supplies, taxes), a restricted talent pool, training workers for production changeovers, lesser process monitoring, increased security treats, and quality issues. With higher trucking rates in the U.S. and a shortage of transportation workers, it is no wonder that so many companies prefer to offshore to China and India, for example, where costs can be up to 70% lower and lead times significantly shorter.⁴

As nearshoring proliferates across the globe, two regions are positioned to benefit significantly. One is Eastern Europe with a rich market of Western European customers. For example, Ukraine has one of the largest pools of IT specialists, and firms such as N-IX with 1,700 professionals, Eleks and Intellectsoft serve clients such as Siemens, Ernst & Young, Jaguar, and T-Mobile Deutsche Telekom.⁵

The other region is Latin America and the Caribbean where real-time collaboration, cultural affinity, cost-effectiveness and a growing talent pool make it the crown jewel for nearshoring operations—in particular Mexico, Colombia, the Dominican Republic, Panama and Costa Rica. Just last year the Association of Latin American Free Zones (AFZA) having launched Relocate Latam, a specialized platform for reshoring, nearshoring and offshoring.⁶

The Inter-American Development Bank's president, Mauricio Claver-Carone, has made nearshoring a priority for his organization, noting: "If Latin America captured just 10% from top ten source destinations outside the western hemisphere, [it] would increase exports by about \$72 billion per year."⁷ The Bank is helping to position Colombia as a hub of business services and assisting Chile to expand its services export sector. In addition, congressional legislation such as Rep. Mark Green's, R-Tenn., Latin American Nearshoring Act also provides incentives for companies to move production facilities or invest in manufacturing and services in the Western Hemisphere. In light of a 2020 Gartner survey found that a third of 260 leading global companies plan to move part of their chains out of China by 2023, the time is ripe for Latin America and the Caribbean to aggressively go after nearshoring business.⁸

Moving workers and production facilities closer to home and relocating plants is a trend that will surely continue. Difficulties in securing raw materials, hiring workers and booking space on ships will not ease up any time soon. Therefore, the outlook for nearshoring is extremely favorable. This is especially true for IT nearshoring (Ukraine, Poland, Romania), call centers (Jamaica, Costa Rica), pharmaceuticals and medical devices as well as automobiles (Mexico). However, the most attractive nearshore industry is apparel. To illustrate, Benetton has moved a lot of production from Asia to Croatia, Serbia, Turkey, Egypt and Tunisia, and German-based Hugo Boss to Poland and Turkey.⁹

⁴ <https://www.mesinc.net/6-reasons-why-near-sourcing-is-not-a-sustainable-solution/>

⁵ <https://www.n-ix.com/top-nearshore-outsourcing-companies/>

⁶ <https://www.asociacionzonasfrancas.org/en/>

⁷ <https://www.bloomberglia.com/2021/08/09/exclusive-nearshoring-could-bring-in-us70-billion-to-latin-america-idb-president-mauricio-claver-carone/>

⁸ <https://www.forbes.com/sites/forbesbusinesscouncil/2021/06/18/subcontract-manufacturing-in-china-the-risks-and-alternative-options/?sh=3f97da257de7>

⁹ <https://biz30.timedoctor.com/nearshoring-examples/>

The factors that drive companies to offshore to low-cost sites are still valid; but other forces as we have seen recently with supply chain bottlenecks have gained greater weight in a firm's sourcing decisions. Considering these developments, along with the growing capabilities of nearshore providers to meet the operational needs of potential customers, one must conclude that the nearshoring future is a bright one.

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