The hollowing out of Northeast Asian manufacturing

At a roundtable lunch I was chairing for Malaysian CEOs in 2010, one of Malaysia’s leading entrepreneurs, the Chairman of Top Glove, Tan Sri Lim Wee Chai, was the guest speaker. He gave a fascinating and insightful assessment of the changing competitive landscape for the rubber glove industry in Asia.

He explained that his original production facilities for rubber gloves had been in Malaysia, which has long been a leading global production hub for natural rubber and had been a competitive location for producing these products. However as Malaysia continued to develop rapidly and experienced rising wage costs, Top Glove eventually opened manufacturing facilities in China, since labour costs were still relatively low in coastal China and the Chinese domestic market for rubber gloves was growing rapidly.

However Tan Sri Lim went on to explain that as China had continued to develop and because Chinese labour costs had started rising rapidly in recent years, Top Glove had decided to significantly increase production in Malaysia, which had become relatively more competitive again in terms of labour costs, as well as from the point of view of factors such as logistics costs for raw materials and the very high quality standards in Malaysia.

Since that time, global multinationals have increasingly voiced their concerns about rising labour costs across a wide range of Chinese manufacturing industries, and many multinationals have decided to establish new production facilities for their low-cost manufactures in other locations, including in Vietnam, Bangladesh and Cambodia.

The economic development of East Asia has been driven by export-led growth, as East Asian nations became low-cost manufacturing hubs for consumer markets in the US and Europe. Japan was the first of the East Asian economies to become an
advanced economy, initially based on a model of low-cost production of manufactures. As domestic wages continued to rise, Japan’s competitiveness as a low cost manufacturing hub was gradually eroded by other competitor nations.

A similar pattern of industrialization has been replicated in other East Asian economies, including South Korea, Hong Kong, Taiwan and Singapore, where the gradual erosion of manufacturing competitiveness due to rising wages has resulted in a shift of production to other low-cost locations.

This pattern of industrial development and shifting competitive advantage was originally described as the “flying geese” model of industrial development by Kaname Akamatsu in the 1930s and became better known internationally following several articles he published in international economic journals during the 1960s. In the “flying geese” model of industrial development, nations first develop competitive advantage in low-cost manufacturing with a relatively unskilled, low paid workforce, but as labour costs rise and the industrial workforce becomes more skilled, the structure of industrial production moves into higher value-added products, losing competitiveness in low value-adding industries. As the manufacturing sector loses competitiveness in low value-added segments of industry, these move to other countries, resulting in a hollowing-out of the manufacturing sector.

**China’s competitiveness in manufacturing**

Since 1978, China became the foremost beneficiary of the hollowing out of more advanced East Asian economies, as multinationals from Japan, South Korea, Taiwan and Hong Kong established factories in mainland China in order to tap the large pool of low-cost labour.

However after over three decades of rapid economic growth during which low-cost manufacturing exports played a key role in China’s rapid economic development, rising wage costs are eroding China’s competitiveness as a low-cost manufacturing export nation. When China first began liberalizing its economy in 1978 and attracting foreign direct investment into low-cost manufacturing, average per capita GDP in China was around USD 180 per year. Since then, Chinese economic growth accelerated to around 10 per cent per year for the next three decades, albeit moderating somewhat during the last four years. This has resulted in Chinese per capita GDP rising to around USD 7,000 per year by 2014.