

Changing the Manufacturing Strategy of China Will Minimise the Expectation of Jobs Being Pushed Towards Countries like India

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[Abstract: Because of rising labour costs, China has been witnessing a contraction in its manufacturing sector, with many labour intensive industries relocating to countries like Vietnam, Indonesia and also India. To address this issue, China quickly introduced a range of policy initiatives laced with attractive incentives to encourage relocation of its labour intensive manufacturing to its poorer provinces where labour is cheap. At the same time it supports technology intensive high-end manufacturing where the ambition of skilled labourers to earn higher wages is being taken care of on the one hand and there are hopes to improve design, quality and productivity to remain globally competitive on the other. China's strong network of value chain and cluster of suppliers and consumers—which neutralises the impact of higher wages to some extent and thus relocation of industry if it happens—will move to its immediate neighbourhood. Thus, expectations of countries like India to see jobs being pushed their side is not going to materialise appreciably.]

In the face of rising labour costs, China has been witnessing a contraction of its manufacturing sector. Countries like Vietnam and Indonesia have been slowly eroding China's advantage of a huge and cheap labour force; resultantly, manufacturers have been facing harder days. Nevertheless, an encouraging development is that China has been incubating a generation of exciting new high-tech manufacturers. From BYD¹, the Chinese maker of electric vehicles, to Huawei Technologies, the telecom equipment giant, genomics research firm BGI² and drone-maker DJI³, the country is now home to an array of innovative companies that belie the notion that China can only do cheap, low-value manufacturing. Encouraged by such initiatives, the State Council of China announced the Made in China (MIC)

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¹ The name BYD is an acronym derived from the phrase "build your dreams."

² BGI, known as the Beijing Genomics Institute prior to 2008, is one of the world's largest genome sequencing centres.

³ Dà-Jiāng Innovations Science and Technology Co. Ltd.

initiative in May 2015—China’s most comprehensive and ambitious industrial plan to upgrade its traditional manufacturing. MIC 2025 aims to mitigate China’s manufacturing problems through a comprehensive upgrading of the sector.⁴

MIC 2025 is the first ten-year action plan which calls for green, innovative and intelligent manufacturing, with focus on quality and internet integration. This plan will be followed by another two plans in order to transform China into a leading manufacturing power by the year 2049 (100th birthday of People’s Republic of China). It will follow a three-step approach:

- By 2025 China will rank amongst the major manufacturing powers;
- By 2035 China’s manufacturing industries will reach the intermediate level among the world’s manufacturing powers; and,
- By 2049 China’s position as one of the world’s major manufacturing countries should be firmly established.

During the first of the above steps, i.e. by 2025, the Chinese industry will be comprehensively upgraded and the Chinese economy will move away from low-end, high-volume, labour-based production towards higher value-added innovation-driven manufacturing, with emphasis on quality over quantity and on optimisation of its industrial structure. The MIC 2025 plan puts forward strategic support and new policies in several areas, including guidelines for improving the financial support policies and creating a market for fair competition. Ten priority areas have been identified in the MIC 2025 plan. They are:⁵

- New advanced information technology
- High-end numerical control machine tools and robotics
- Aerospace equipment
- Ocean engineering and high-tech shipping
- Modern rail transport equipment

⁴ Lee, Xin En (2015), ‘Made in China 2025: A New Era for Chinese Manufacturing,’ *CKGSB Knowledge*, September 02. Available at: <http://knowledge.ckgssb.edu.cn/2015/09/02/technology/made-in-china-2025-a-new-era-for-chinese-manufacturing/>

⁵ *Ibid.*

- Energy saving and new energy vehicles
- Power equipment
- New materials
- Biopharma and high performance medical devices
- Agricultural machinery

A small group under the state council has been created to establish coordination among interest groups to push forward implementation of the plan.

Despite the fact that China's reputation as the factory of the world comes into focus when some reputed manufacturers relocate themselves to neighbouring countries in Southeast Asia and to India, China continues to dominate manufacturing. In 2013, the output value of China's equipment manufacturing industry surpassed \$3.2 trillion, accounting for one-third of the global total. Among the 500 major types of industrial products, China ranks first worldwide in terms of output in more than 200 categories. However, most Chinese factories are still far from automation, and a long way away from reaching the MIC 2025 vision.⁶

The scenario presents opportunities for world economy in the MIC 2025 vision. The long-term goal of the plan is to adapt the Chinese manufacturing infrastructure to meet the needs of high accuracy, high speed, high efficiency, high flexibility and high reliability. Obviously, during the early stage of MIC 2025, due to industrial upgrading and technical transformation of downstream industry, there will be a demand for imported high-end CNC machine tools, complex machines, combined machines, complete set of equipment, production line as well as complete solutions with specific processing technology. In core manufacturing industries such as aerospace, automotive, shipbuilding, power generation and transportation infrastructure, China will have to rely on imports to acquire high-tech, productive machine tools. China might be able to quickly narrow its competition gap with developed countries by applying internet technology to manufacturing. Yet to meet the immediate goals of the MIC 2025 to improve quality, productivity and

⁶ *Ibid.*

digitisation and to expand the use of numerically controlled machines, it will have to acquire high-quality tailor made critical components & technology from advanced countries, giving a push to their economies as well.

The MIC 2025 drive for use of robotics in manufacturing will give tremendous boost to the global robotics industry and China will emerge as the biggest and fastest growing market worldwide even though presently the robotic density of Chinese production industries is just 36 units per 10,000 workers, which is much lower than that of developed countries—365 in South Korea, 211 in Japan, and 161 in Germany. Foreign investors from advanced and developed countries are planning a rapid expansion in China.⁷

A few months before China unveiled its MIC 2025 programme, the Government of India unveiled its Make in India plan, also targeted at manufacturing. While MIC 2025 is a ten-year campaign to push the country beyond labour intensive work into more sophisticated sectors—from robotics to aerospace, India's goal is to bring basic manufacturing to an economy that needs more decent paying jobs. While China has set its sights on rivaling Germany or Japan, India aims at settling where China is now positioned.

China is far ahead of India in terms of Gross Domestic Product (GDP) and its manufacturing sector is 10 times bigger—at about \$3 trillion. China has reasons to pursue an upgrade as explained in the preceding paragraphs. In India, on the other side, the share of manufacturing in overall economy has been languishing at around 18 per cent for the last several years, leaving a surfeit of agricultural workers waiting for better opportunities. The focus of the Make in India campaign is on raising the share of manufacturing to 25 per cent by 2022 and to bring in foreign investment. Many of the 25 industries identified under the Make in India initiative are sectors that are not exactly cutting edge, such as textiles, leather and mining. The promotion

⁷ *Ibid.*

of the manufacturing sector in India will thus start from a very low base and will aim to capture a lot of low-skilled jobs that are leaving China.⁸

Despite the rise in manufacturing wages in China and the Yuan rising to an all-time high, it will be unrealistic to presume that China's days as a manufacturing powerhouse are numbered. Manufacturing in China has underappreciated strengths. Sixty five per cent of the components or ingredients in goods that China sells to the world are made at home, up from 40 per cent in the mid-1990s. As domestic consumption rises, Chinese firms are getting better at designing products that suit consumers' wants. By hosting more of supply chains, China has been able to boost its manufacturing competitiveness and has also attracted more investment. Despite high—and fast-rising—wages, many supply chains prefer to stay put in China because of the dense cluster of suppliers and customers and also, because China's factories are still far cheaper than their rich-world rivals. Many pay their employees just above the minimum wage, which is less than a quarter in America. The productivity of Chinese workers is far higher than their rivals in Southeast Asia. And, when the Chinese pour more money in automation, productivity will improve further.

Chinese firms are also pursuing low-wage manufacturing opportunities in the country's interiors, especially in areas where provincial administrators provide tax-breaks and cheap land. They also have a vast labour pool, excellent transport links and a reliable supply of inputs.⁹

As a result, China remains competitive in low-end production. Its share in global clothing exports, for example, rose from 42.6 per cent in 2011 to 43.1 per cent in 2013, while the prices of Chinese-made goods sold in the US have actually fallen

⁸ Bloomberg (2015), 'Made in India Vs Made in China: Two Paths towards Industrialisation,' *The Economic Times*, June 02. Available at: <http://auto.economictimes.indiatimes.com/news/industry/made-in-india-vs-made-in-china-two-paths-towards-industrialisation/47509361>

⁹ The Economist (2015), 'The Future of Factory Asia: A Tightening Grip,' March 12. Available at: <http://www.economist.com/news/briefing/21646180-rising-chinese-wages-will-only-strengthen-asias-hold-manufacturing-tightening-grip>

by almost 2 per cent in the last three years. This explains that the Chinese can control costs; besides, their excellent infrastructure helps.

Nevertheless, Chinese workers are becoming increasingly vocal about their rights; they want to break free from the drudgery and suffering of daily life, which are the consequences of low-wage employment. China is also ageing rapidly. The neighbouring Southeast Asian countries like Indonesia and Vietnam are attractive destinations for relocation. These countries are not only geographically close to China, but also the rising level of consumption in China is helpful to manufacturers located in nearby countries as the average distance travelled to transport consumer goods is smaller, which helps reduce transportation costs.

Thus, no one country will replace China's role in Factory Asia. Advances in communications technology mean that manufacturing can be sliced and diced more easily than in the past. Thus, all ASEAN members will benefit from the dispersion of China's labour-intensive industries into their own territories. The region will reap the benefits of integrating, provided it rationalises the tariff structure and invests in improvement of infrastructure and skill development of its workers.¹⁰

In order to contain the losses of low-end manufacturers to other countries, China is giving them incentives to relocate to its lower-cost parts. At the same time, however, China wants to raise wages as well as spur consumer demand by taking high-tech manufacturing to yet higher levels such as robotics and semiconductors under MIC 2025. Thus, policymakers walk a fine line while trying to keep wages from rising so fast that they undermine competitiveness for one type of factory work on the one hand and promoting other types of factory work to boost incomes to create a more consumer-driven economy on the other. China has been able to manage to keep its share of global manufacturing output at 25 per cent in 2015, up from 7 per cent in 2000. To contain the loss of industries to low-wage countries, it has offered subsidies and a range of incentives for manufacturers to relocate to cities in western

¹⁰ Magnier, M. (2016), 'How China is Changing its Manufacturing Strategy,' *The Wall Street Journal*, June 2016. Available at: <https://www.wsj.com/articles/how-china-is-changing-its-manufacturing-strategy-1465351382>

and central China, where wages are as much as 30 per cent lower than in eastern provinces. Besides, the provinces are providing tax benefits, rent and power subsidies, particularly in cotton growing states to support the textile industry. China has managed to hold on to its low-end industries far longer than its Asian neighbours at a similar stage of development. Normally, as countries get richer, they move up the value chain and it is expected that low-end manufacturing will move away. In China, this is not happening—at least as much as one would expect.¹¹

From the foregoing analysis it is clear that because of fast-rising wages, much of the low-cost activities have passed on from China to the large low-income populations in Southeast Asia, which has reinforced a regional supply chain with China at the centre. China at the same time has increasingly become a lynchpin of demand. Chinese consumer demand is strengthening the Asian supply chains as local suppliers have an edge over distant rivals. Countries like India will find it difficult to lure many industries away from China and outside the region of Southeast Asia.

The Make in India initiative has an undaunting task ahead as it seeks to increase the share of manufacturing in GDP from the existing 16–18 per cent to 25 per cent and create 100 million jobs by 2022. Global manufacturing is changing very fast; it no longer offers employment or income gains that it once did. While in the past, export-led manufacturing offered a way for a large number of unskilled workers to move from field to factory, now technological advances have left fewer workers on factory floors. China may have been one of the last countries to climb up the ladder of development simply by recruiting lots of unskilled people to make things cheaply. Exports remain the surest path to success for emerging markets as competing in global markets is the best way to increase productivity and quality using automation.¹² In their quest for increasing productivity, the US, Europe and Japan lost 17 million jobs in manufacturing between 2000 and 2010. In this scenario,

¹¹ The Economist (2015), 'Global Manufacturing: Made in China?' March 12. Available at: <http://www.economist.com/news/leaders/21646204-asias-dominance-manufacturing-will-endure-will-make-development-harder-others-made>

¹² Bagga, A. (2016), 'Unless Urgent Steps are Taken, Make in India will Remain a Non-starter,' *The Wire*, February 08. Available at: <https://thewire.in/21057/unless-urgent-steps-are-taken-make-in-india-will-remain-a-non-starter/>

India will find it tough to create even a fraction of the ambitious 100 million manufacturing jobs that it aims at under the Make in India campaign.¹³ Countries like India will have to rely on several engines of development—not just manufacturing but agriculture and services, too. India’s IT services sector has already shown what can be achieved, but it is high-skilled and barely taps into country’s ocean of labour.¹⁴

Policymakers should look to compete hard on factors beyond manufacturing labour costs and expecting that higher Chinese wages will push jobs their way. While advocating that India should attract firms moving out of China, Arvind Panagariya, Vice Chairman, Niti Aayog, Government of India, is conscious of the fact that right now manufacturing from China is being relocated to Vietnam, Bangladesh, Sri Lanka and some to India also.¹⁵ India in fact may be one of the distant beneficiaries of manufacturing relocating from China. Not many jobs will thus be pushed towards India.

¹³ The Business Standard (2016), ‘India should Attract firms moving out of China: Arvind Panagariya,’ March 22. Available at: http://www.business-standard.com/article/economy-policy/india-should-attract-manufacturing-firms-moving-out-of-china-arvind-panagariya-116032201191_1.html

¹⁴ *Op. cit.* 11

¹⁵ *Op. cit.* 13