

Shifts in Cost Competitiveness Reshape Global Manufacturing

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The multifaceted matrix of global sourcing and supply chain management is constantly shifting with changes in wages, energy costs and currency values, and today, these factors are redrawing the map of global manufacturing cost competitiveness.

In a Boston Consulting Group (BCG) report titled, “[The Shifting Economics of Global Manufacturing](#),” researchers noted that cost competitiveness is changing worldwide. While Latin America, Eastern Europe and most of Asia were once viewed as low-cost regions, and the U.S., and Western Europe and Japan considered high, that notion is now outdated. Instead, all regions consist of a “quilt-work” pattern of low- and high-cost economies, and those that fall between.

“In some cases, the shifts in relative costs are startling. Who would have thought a decade ago that Brazil would now be one of the highest-cost countries for manufacturing—or that Mexico could be cheaper than China? While London remains one of the priciest places in the world to live and visit, the UK has become the lowest-cost manufacturer in Western Europe. Costs in Russia and much of Eastern Europe have risen to near parity with the U.S,” the report noted.

BCG looked at the world’s 25 leading export economies including China, the U.S., U.K., Canada, Mexico, India, Brazil, Indonesia and Russia, and examined them against four key dimensions: manufacturing wages, labor productivity, energy costs and exchange rates. The 25 economies surveyed represent roughly 90 percent of total global manufactured goods exports.

“The new BCG Global Manufacturing Cost-Competitiveness Index has revealed shifts in relative costs that should drive many companies to rethink decades-old assumptions about sourcing strategies and where to build future production capacity,” the report noted.

To compare the cost shifts, BCG looked at data from 2004 and 2014 and found that manufacturing cost competitiveness has improved for several countries and become much less attractive for others, pointing to four distinct patterns of change.

Economies that were once considered low-cost have come under pressure in recent years—namely Brazil, China, the Czech Republic, Poland and Russia—and in several of these countries, manufacturing costs are now estimated to be higher than in the U.S.

Brazil experienced the most dramatic shift as its average costs in 2004 were roughly 3 percent lower than in the U.S., and today BCG estimates they are 23 percent higher. Factory wages in the South American nation have more than doubled in the last 10 years, but productivity did not pick up at the same pace. Productivity increased just 1 percent over the 10 year period, making Brazil 19th out of 25 on this metric.

Rising costs in China have been a hot topic this year as brands look to other low-cost locales to make goods. According to the report, “China’s estimated manufacturing-cost advantage over the U.S. has shrunk to less than 5 percent.” In 2004, China’s wage rate was roughly \$4.35 an hour, and that number has now nearly tripled to an estimated \$12.47 an hour. Russia’s cost competitiveness has also eroded over the period. While wages in the country were an estimated \$6.76 10 years ago, today they total \$21.90. The cost of industrial electricity increased 66 percent in China and 78 percent in Russia in the decade, and the cost of natural gas jumped a high 138 percent in China and an estimated 202 percent in Russia.

Traditional high-cost countries like Australia, Belgium, France, Italy, Sweden and Switzerland have continued to lose ground in the last 10 years, and now cost gaps relative to the U.S. are between 16 and 30 percent.

“Rising energy costs, strong currencies, and weak productivity growth are the main culprits,” according to the report. “Electricity costs have risen by an average of 59 percent in the six economies. Natural-gas costs have soared by an estimated 94 percent since 2004 on average. Wages in those countries losing ground rose by approximately 10 percent more than they did in the U.S., while productivity growth lagged that of the U.S. by an estimated 10 percent.”

But some countries’ cost competitiveness is holding steady. In India, Indonesia, the Netherlands and the U.K., overall costs changed by no more than 2 percent in either direction, compared to the U.S.

“Rapid productivity growth and depreciating currencies have helped keep costs in check in economies such as India and Indonesia—even as wages have grown quickly,” the report noted. Though the manufacturing cost change has been less dramatic than in India and Indonesia, the Netherlands and the U.K. have also been stable across the four cost drivers, positioning the four countries as “potential future leaders in each of their respective regions.”

The U.K.’s flexible labor market has been a competitive edge, BCG noted, and it has now emerged as the lowest-cost manufacturing economy in Western Europe, just ahead of Spain.

BCG also identified countries they consider to be “rising global stars,” including the U.S. and Mexico. “Cost structures in Mexico and the U.S. improved more than in all of the other 25 largest exporting economies,” the report noted. “Because of low wage growth, sustained productivity gains, stable exchange rates, and a big energy-cost advantage, these two nations are the current rising stars of global manufacturing. We estimate that Mexico now has lower average manufacturing costs than China on a unit-cost basis. And except for China and South Korea, the rest of the world’s top-ten goods exporters are 10 to 25 percent more expensive than the U.S.”

The manufacturing cost gap between the U.S. and other highly developed nations has widened considerably in the past decade. According to the report, U.S. costs are now an estimated 9 percentage points lower than in the U.K., 11 points lower than in Japan, 21 points lower than in Germany and 24 points lower than in France.

High labor productivity and energy cost advantages have been key to the growing U.S. competitive advantage. Industrial prices for natural gas, for example, have risen globally, but have fallen by roughly 50 percent in the U.S. since 2005, making energy costs more than three times that of the U.S. in countries like China, France and Germany.

These changes in relative costs could drive a considerable shift in the global economy, BCG noted, and one implication is that global manufacturing could become more regional.

“Because relatively low-cost manufacturing centers exist in all regions of the world, more goods consumed in Asia, Europe, and the Americas will be made closer to home,” the report noted. “These trends also have implications for governments, whose leaders increasingly recognize the economic importance of a stable manufacturing base.”

To sustain or regain cost competitiveness, manufacturers will have to increase value added by each worker, account for all costs beyond just labor and energy, and realign global strategies considering future demand for products in each region and determine the optimal sources for goods, BCG noted.

“Companies that build production capacity based on outdated concepts of cost competitiveness—and that fail to factor in scenarios for long-term trends—risk placing themselves at a serious disadvantage for two to three decades. The winners are likely to be companies that align their operations with the shifting economics of global manufacturing—and that build in the flexibility to shift gears as those economics continue to evolve,” the report concluded.