# If This Trend Continues...

Twenty years ago, South Koreans were proudly looking forward to hosting the Summer Olympics. For a country that had made extraordinary strides after a ruinous civil war in the early '50s, the Olympic games were seen as a "coming out" party of sorts. As construction workers in Seoul were putting the finishing touches on the Olympic Stadium, a group of U.S. guitar manufacturers were in Washington D.C. asking the International Trade Commission for tougher duties on Korean-produced instruments. Their argument was straightforward: Exceptionally low labor costs and high productivity had made Korean music manufacturers unbeatable competitors, and if their growth continued unabated, they would end up owning the world market.

Subsequent events showed that U.S. manufacturers' fears were unfounded. The Seoul Olympics and the ITC hearing in 1988 came precisely at the high-water mark for the Korean music industry. After 1988, rising real-estate prices, higher labor costs, and a tougher regulatory climate effectively blunted the once fearsome Korean competitive advantage. Some Korean firms reacted by moving production to China and Indonesia, while a great many others simply shut down. National guitar production, which had peaked at 1.4 million units in 1988, is now less than 200,000 units and Korea scares no one.

As this issue goes to press, China is preparing to host the Summer Olympics and the parallels with South Korea are striking. Like Korea, China used the combination of low labor costs and an industrious populace to become the world's leading manufacturer of musical products. However, the cost advantages that propelled this two-decade growth spree are now under siege. With recently passed laws mandating higher employee contributions to a state-run pension program, a shorter work week, and an increase in overtime pay, Chinese labor costs have risen by approximately 30%. Simultaneously, tax rebates on exports have been trimmed from 17% to 13%. The Chinese currency has also appreciated 14% against the dollar in the last 18 months. Before factoring in the surging costs of raw materials, these changes have dramatically altered the cost structure of every Chinese factory.

It's doubtful that China's music industries will follow the same trajectory as South Korea's. Unlike Korea, with its limited geography, China has a vast landmass to exploit. Just as at the turn of the 20th century U.S. manufacturers began migrating from urban centers to lower-cost rural areas, Chinese manufacturers are beginning to move operations to lower-cost inland regions, away from densely populated coastal cities like Shanghai and Shenzhen. Long term, this ensures that China will remain a vital source of supply for the global music products industry. In the next 18 months, however, expect eye-popping price increases.

A short time from now, U.S. retailers could very well be paying 10% to 20% more for all Chinese-made guitars, pianos, band instruments, and electronics. The prognosis for surging prices is mixed. One of the few immutable economic laws is that higher prices translate into fewer sales, so it's a safe bet that unit volume of most products will trend down. However, after a decade of acute price deflation (between 1998 and 2007, the average selling price of an acoustic guitar dropped from $561 to $382), higher average selling prices may actually help retailers bolster their bottom line. In short, the decrease in unit volume may be offset by higher prices.

Chinese price increases are prompting many companies to investigate shifting production to Vietnam, India, and Thailand, so expect new sources of supply to arise. The higher prices will also probably affect the distribution channel. A 10%-higher price tag will probably have little impact on the typical m.i.-store customer shopping for a guitar. However, that same 10% jump might prompt the harried mom at Wal-Mart to keep walking past the instrument display.

If nothing else, this rapid change validates the wisdom of Yogi Berra, who once observed, "Predictions are hard, especially when they're about the future." A year ago, significant price increases were barely on any retailer's radar. Today, they're front and center. The overwrought commentators who were busy predicting Chinese world dominance may also have to revise some of their forecasts.

We have no formula for producing an accurate forecast, but here's a surefire tip for spotting a faulty one. Head the other way whenever you encounter the four words, "If this trend continues." Trends never continue in a straight line, they're inevitably interrupted by unforeseen events, like rising labor costs in Korea and China to cite two examples. If prices continue rise rapidly, the industry could suffer. Fortunately, something will come along to upset the trend.

**Brian T. Majeski**
**Editor**
Email: brian@musictrades.com