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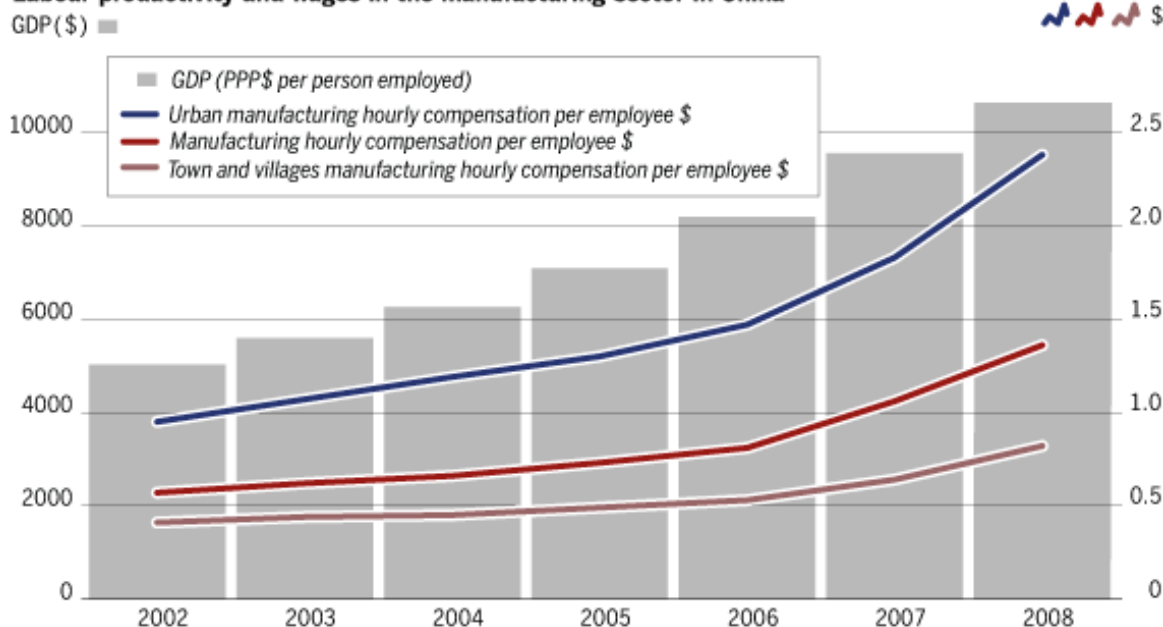
Chart of the week: Chinese wage inflation raises doubts over cheap labour

April 5, 2011 1:18 pm by Valentina Romei

Wage inflation in China has raised questions over the country's future as the preferred outsourcing destination for multinationals in search of cheap labour.

Reliable numbers are hard to get. But a US Bureau of Labor Statistics report published on Friday shows that between 2002 and 2008, real hourly wages in China's manufacturing sector doubled, while they rose by barely 20 per cent in the US. Nevertheless, despite the increase, wages in Chinese manufacturing in 2008 were still only about 4 per cent of those in the U.S.

Labour productivity and wages in the manufacturing sector in China



Source: BLS, IMF

Our chart this week shows the nominal hourly compensation per employee in the manufacturing sector in China as a whole, and split between urban areas and rural towns and villages. Employee compensation is compared to nominal labour

productivity over the same period, expressed as GDP per head, calculated in US dollars according to purchasing power parity.

Wages are significantly higher in urban locations than in rural ones. This means that in 2008 about two thirds of manufacturing workers in China were paid just \$0.80 an hour, with the other third in urban areas getting an average of \$2.40 an hour.

Moreover, whereas urban workers increased their earnings to about 7 per cent of the corresponding US compensation in 2008 from about 3 per cent in 2002, earnings in rural areas increased only marginally to just above 2 per cent of US wages.

The speed of increase in hourly compensation accelerated from 2006 for both rural and urban workers and further rises are expected from 2009 following the enactment of a new employment law. It gives workers the right to a signed labour contract with limits on overtime work, compulsory social insurance and timely payment of wages.

This law and others governing minimum wages are contributing to wage inflation in China but they are not the only factors. Labour shortages in urban areas – exacerbated by slower rates of migration and lower rates of fertility – and rising standards of education also contribute to the surging costs of labour in Chinese manufacturing.

However, if Chinese manufacturing workers have never had it so good, their earnings are still very low compared to those in advanced countries and lower than in many other Asian emerging countries including Taiwan and the Philippines.

Furthermore, the rise in Chinese wages becomes marginal when the increase in labour productivity is taken into account. Chinese labour productivity has been rising sharply at about 10 per cent a year since the early 1990s and even more quickly in the past decade, due to technological progress, increased capital investment and rising human capital. Chinese factories may have higher labour costs but they need fewer workers to produce the same or larger amounts of goods, largely offsetting the increase in compensation.

Moreover, the rise in productivity has been accompanied by structural changes in what manufacturing workers actually produce. From exporting mainly footwear and clothing in the 1990s, China's largest exports have shifted to computers, computer parts and telecommunication equipment. According to the World Bank, the overall proportion of high-tech goods in Chinese exports rose from about one fifth at the beginning of the decade to almost a third in 2008.

As China's universities produce more and more researchers – the number doubled

between 2002 and 2008 - China is becoming less appealing to multinationals producing cheap low-value-added goods, but much more appealing to those making cheap high-value-added goods, both finished and intermediary.

China is changing from a source of cheap labour with low productivity for finished low-cost goods, into a key element in the global manufacturing production chain. Indeed, China attracted twice the amount of foreign direct investment in 2008 that it did in 2002, and has become the main export destination of neighbouring emerging Asian countries producing manufacturing components. Those components – together with parts produced in the country – will be assembled in China using its still cheap labour force combined with higher productivity, technology and human capital.

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