“Do China’s rising wages mean the end of its competitive edge?”

Ian Sheldon
Andersons Professor of International Trade
Despite global recession, value of China’s total trade accounted for 48% of GDP in 2011.

Expanded participation in trade driven by:

- migration of 150 million workers
- access to technology, capital and inputs
- entry of multinational firms
- accession to WTO in 2001

Through 2000s, China maintained trade surplus at an average of 5% of its GDP – major contributor to global economic imbalances.
China’s Trade Balance (% of GDP)

Source: Lemoine and Ünal, 2012
US and EU industry have faced increase in import competition from China without offsetting increase in demand for their exports

Despite weaker global demand after 2008, China continues to run bilateral surplus with US and EU

Trade deficit with Asia due to it being part of “factory Asia”, i.e., China imports components and exports finished goods to rest world

China’s trade deficits with Africa and Middle East based on demand for commodities
China’s Trade Balance by Regions (US$ billion)

Source: Lemoine and Ünal, 2012
China has competitive edge in labor-intensive industries – shifting over past decade from footwear and toys to electronics

Due to availability of cheap labor, multinational firms have outsourced assembly to China

Triggered fast employment growth and rural-urban migration

Over 2000s, China’s average real wages rose by 13.8%/annum - could reduce its competitiveness

Real exchange rate has strengthened by 50% - multinational firms may outsource from elsewhere
China’s Top Export Products

- Toys/games
- Footwear
- Cell phones/TVs
- Computers

Source: Hansen 2012
Real Annual Wages of Chinese Urban Workers (2010 prices)

Source: Li et al., 2012
China’s Real Exchange Rate (2003=100)

![China's Real Exchange Rate Graph](image)
Why rising wages?

- reforms to urban labor markets mean private sector is setting wages linked to productivity
- slower growth in China’s labor force due to declining birthrate
- migration influenced by *hukou* residency system – rural residents allowed to migrate but cannot take advantage of urban public services
- cost of migration has created surplus of labor in rural areas and rising migrant wages in urban areas
2012: 270 million living in urban areas had rural *hukou* – 40% of urban population
- One-child policies (1973/79) more strictly enforced in urban than rural areas
- Urban population clearly started shrinking at time of one-child policy
- As more than 70% of population has rural hukou, limited effect of one-child policy on rural population dominates
- China’s labor force will have to be predominantly drawn from rural areas
- Less a problem of migrant labor shortage and more an issue of constraints on migration
China’s Population Pyramid (2000)

"Echo" effect of Great Famine in late-1950s

Born in 1973
Born in 1979

Source: Meng, 2012
Competitiveness also depends on productivity – grown at 11.3%/annum over past decade

Increased investment in R&D and capital/worker

Greater access to college education has raised quality of labor and returns to education in China

If productivity growth continues at this rate, China will switch to manufacturing more skill-intensive, and higher value-added goods

Already evidence for China capturing more links in global production chains – Lenovo now ranked as world’s largest seller of PCs
Returns to Education in Urban China

Source: Li et al., 2012
China’s Imports and Exports of Computer Parts

Source: Hansen 2012
For China to transition smoothly to more skill-intensive, middle-wage economy, labor and rural land market reforms essential

Cost of migration could be reduced through relaxation of urban *hukou* privileges, but there are constraints:

- $8.2$ trillion required to accommodate 100 million new migrants by 2020 (China Development Bank)
- Urban dwellers want to maintain preferential access to jobs, education and health care
Holders of rural *hukou* have high savings rates – need to release consumption potential and aid in rebalancing of China’s economy

Rural land and home ownership rights should be established, allowing farmers to sell up and migrate to cities

Collective control of land is a problem – local governments can dispossess farmers of land they lease – 16.5 million acres over 1990-2010 period

However, local experiments allowing farmers to borrow against homes could be scaled up