



THE OHIO STATE UNIVERSITY

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

Ian Sheldon

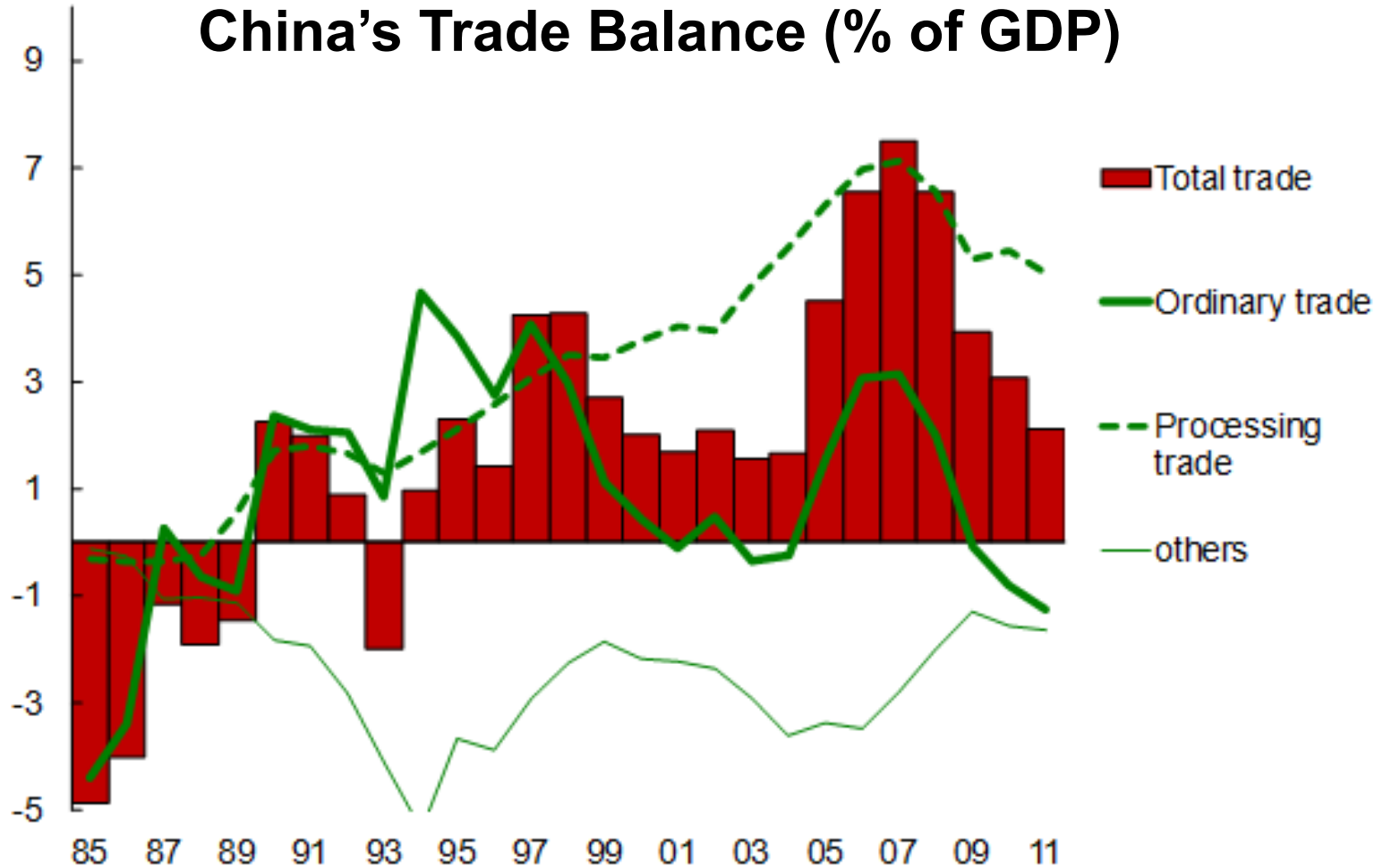
Andersons Professor of International Trade



- **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)

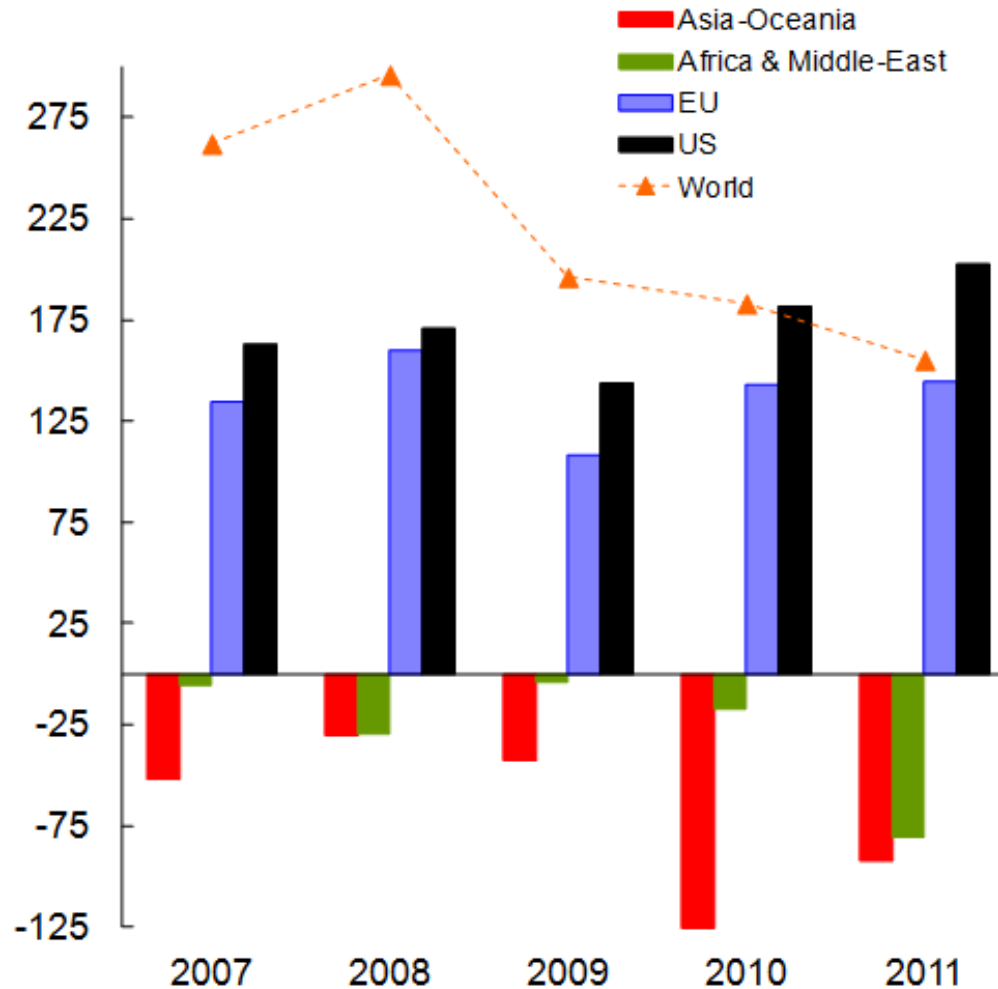




- **US and EU industry have faced increase in import competition from China without offsetting increase in demand for their exports**
- **Despite weaker global demand after 2008, China continues to run bilateral surplus with US and EU**
- **Trade deficit with Asia due to it being part of “factory Asia”, 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)

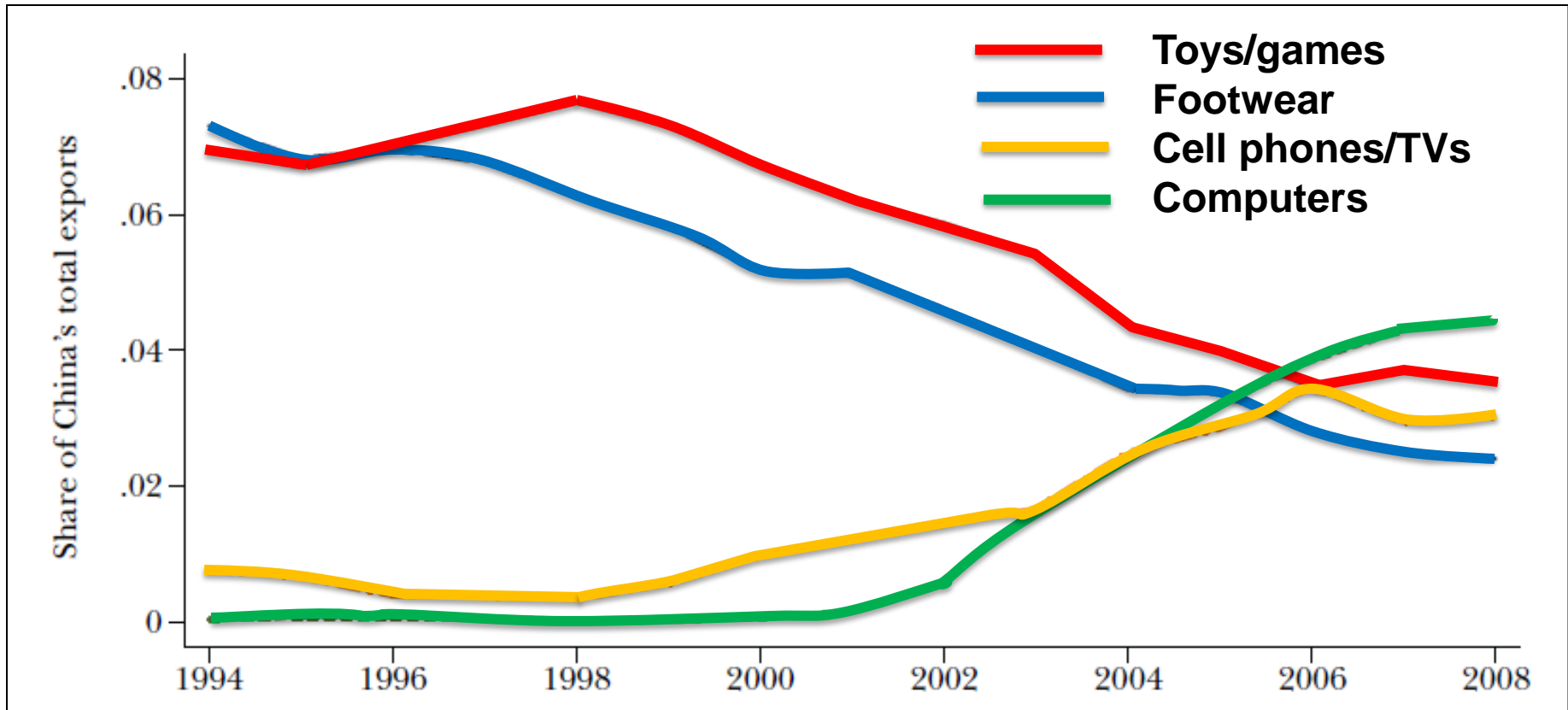




- **China has competitive edge in labor-intensive industries – shifting over past decade from footwear and toys to electronics**
- **Due to availability of cheap labor, multinational firms have outsourced assembly to China**
- **Triggered fast employment growth and rural-urban migration**
- **Over 2000s, 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**

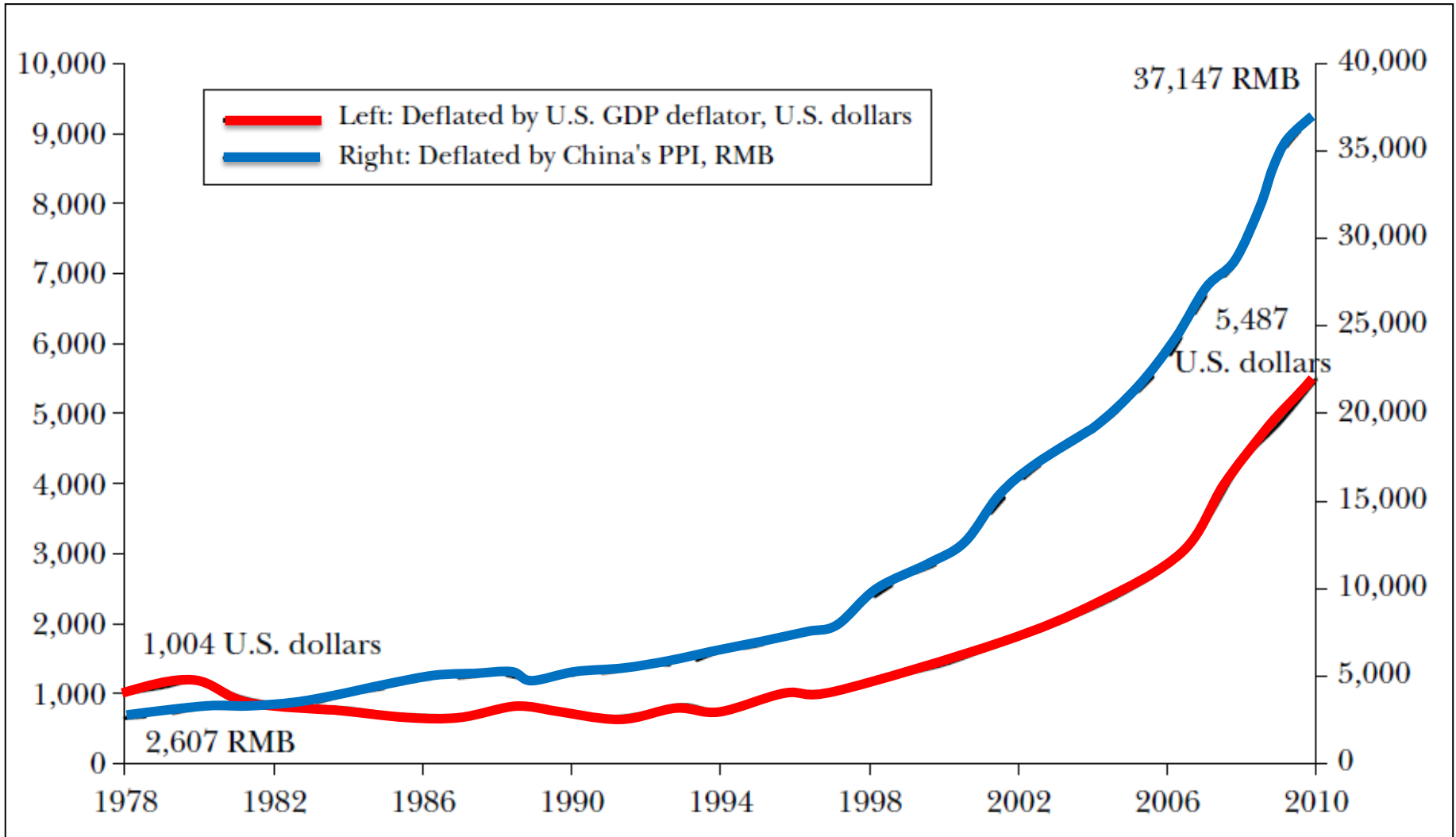


China's Top Export Products



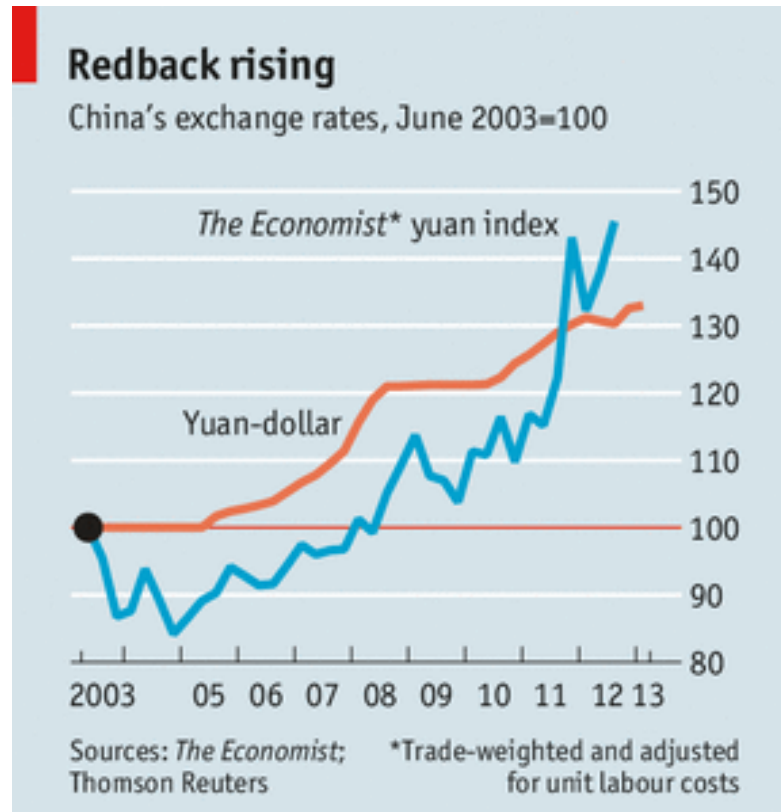


Real Annual Wages of Chinese Urban Workers (2010 prices)





China's Real Exchange Rate (2003=100)



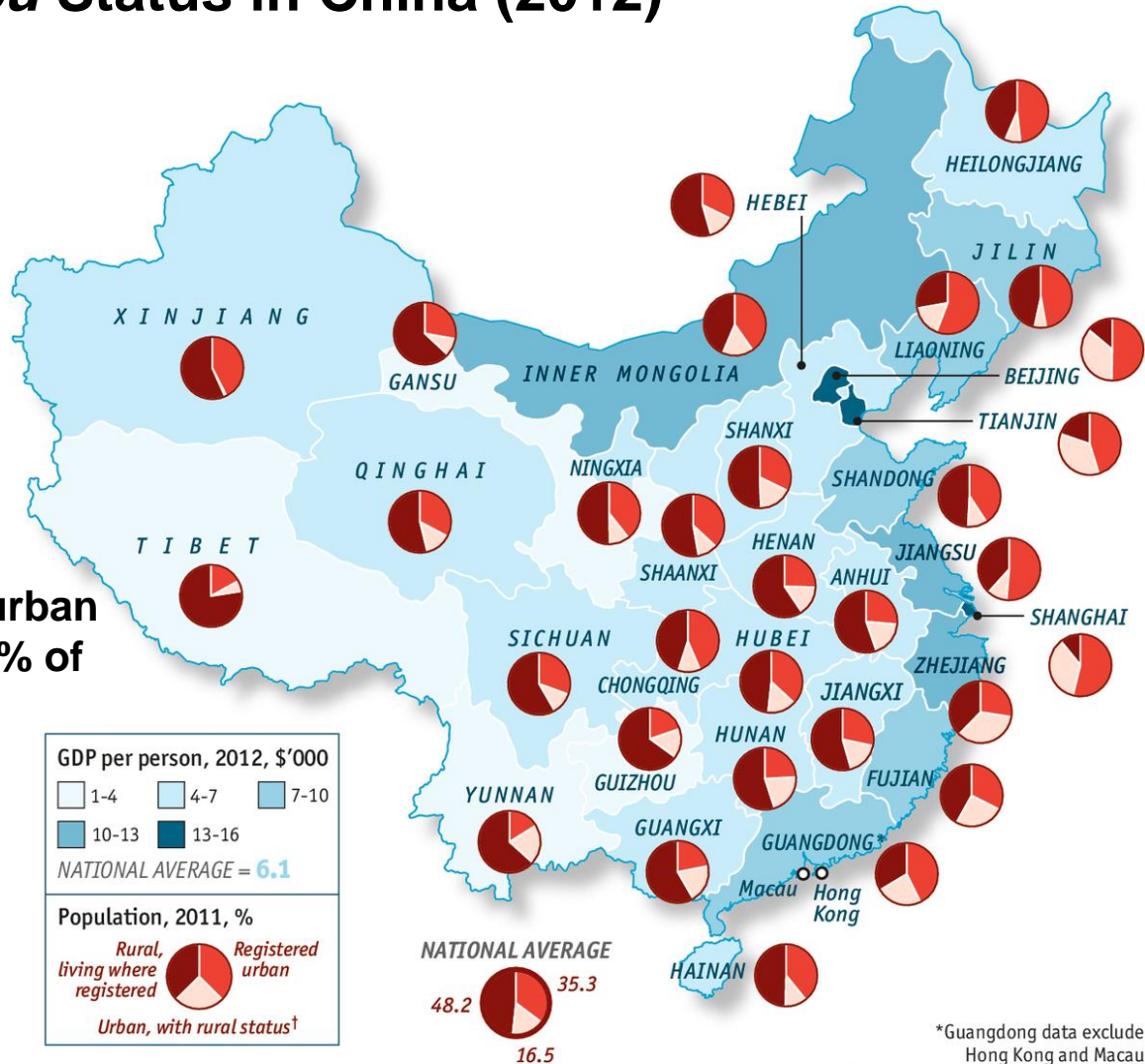


- **Why rising wages?**
 - **reforms to urban labor markets mean private sector is setting wages linked to productivity**
 - **slower growth in China's labor force due to declining birthrate**
 - **migration influenced by *hukou* residency system – rural residents allowed to migrate but cannot take advantage of urban public services**
 - **cost of migration has created surplus of labor in rural areas and rising migrant wages in urban areas**



Hukou Status in China (2012)

2012: 270 million living in urban areas had rural *hukou* – 40% of urban population



Sources: Haver Analytics; *The Economist* estimates

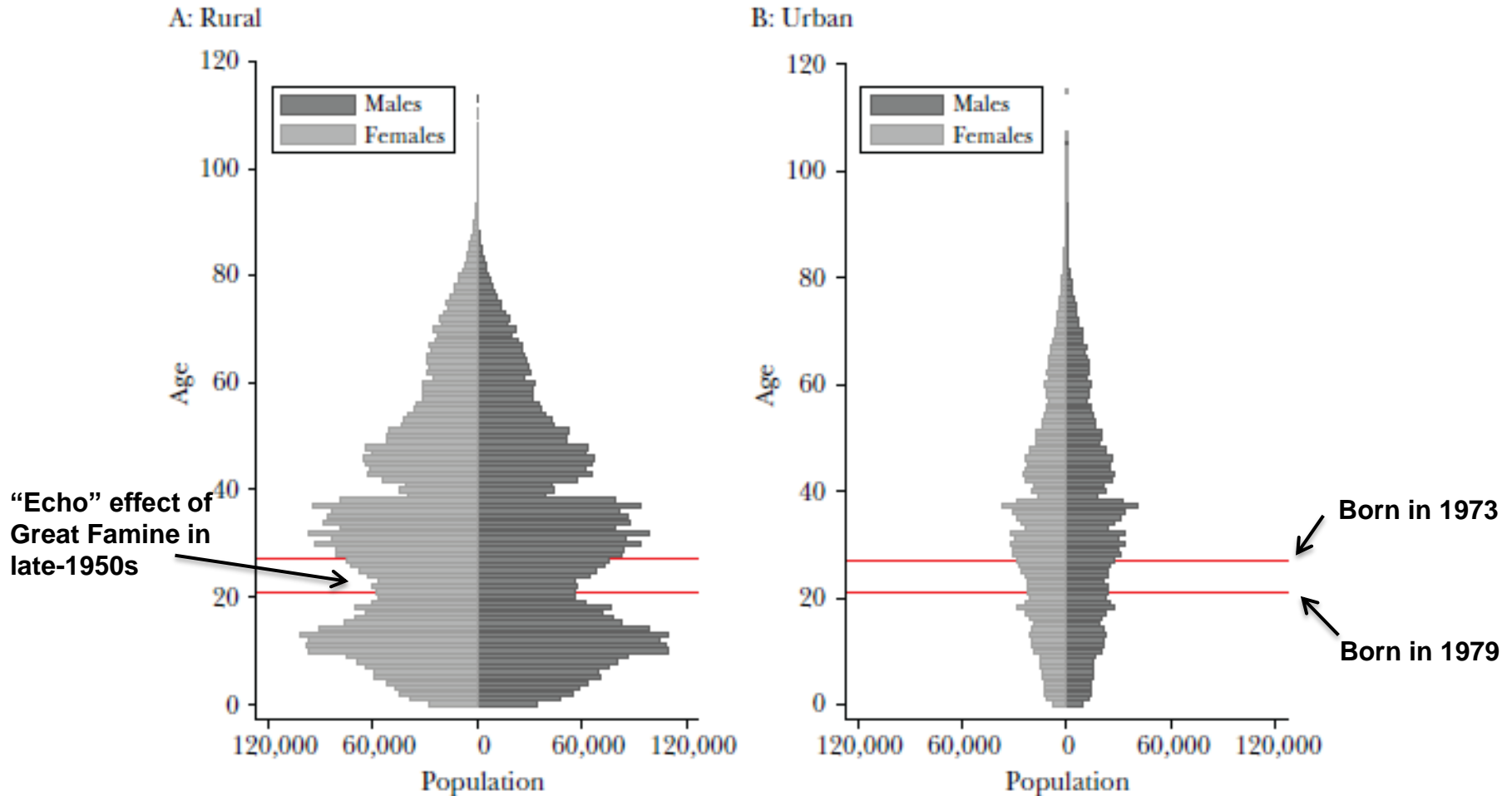
*Guangdong data exclude Hong Kong and Macau
[†]Registered as rural, living elsewhere



- **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)

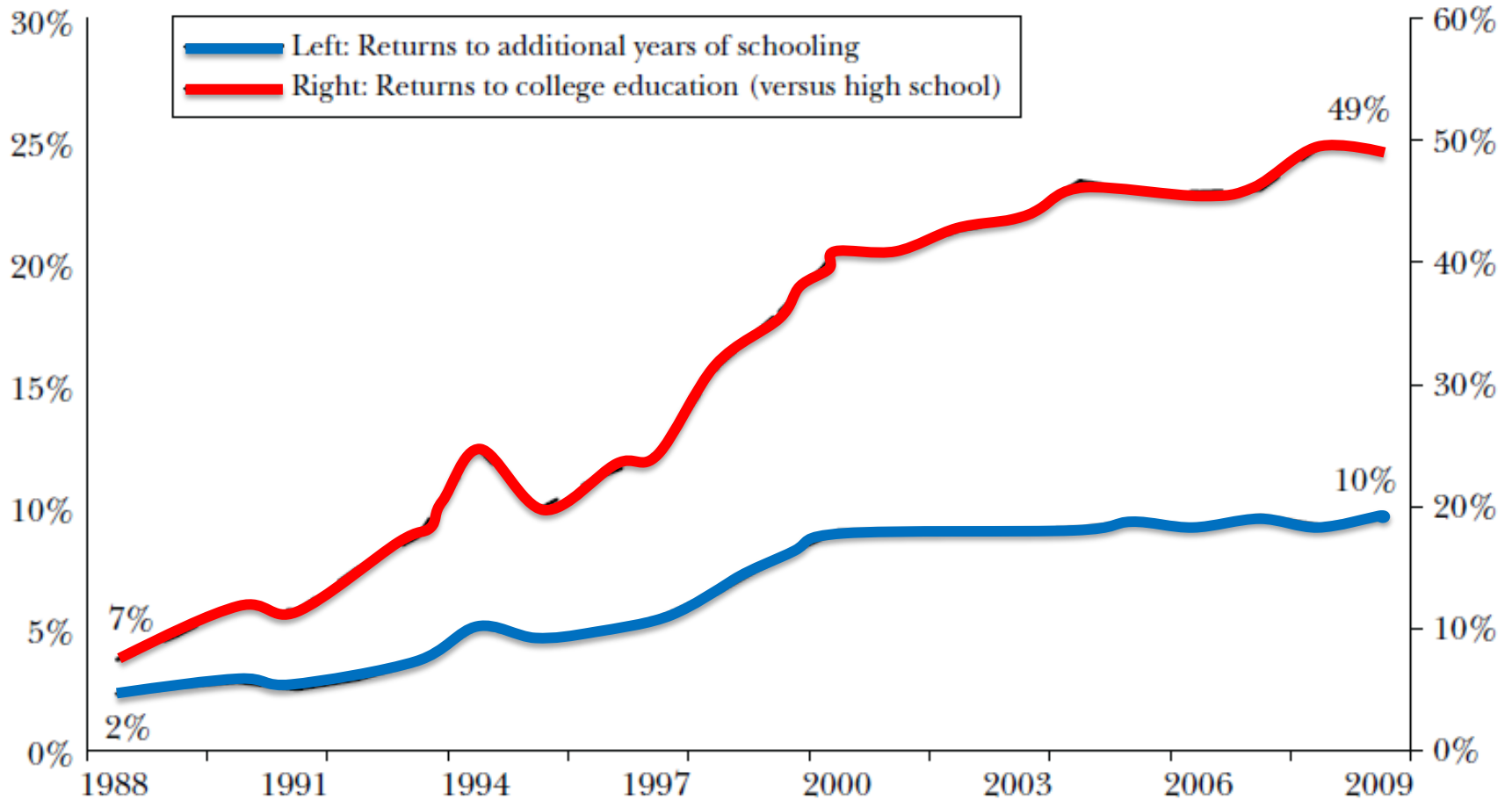




- **Competitiveness also depends on productivity – grown at 11.3%/annum over past decade**
- **Increased investment in R&D and capital/worker**
- **Greater access to college education has raised quality of labor and returns to education in China**
- **If productivity growth continues at this rate, China 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**

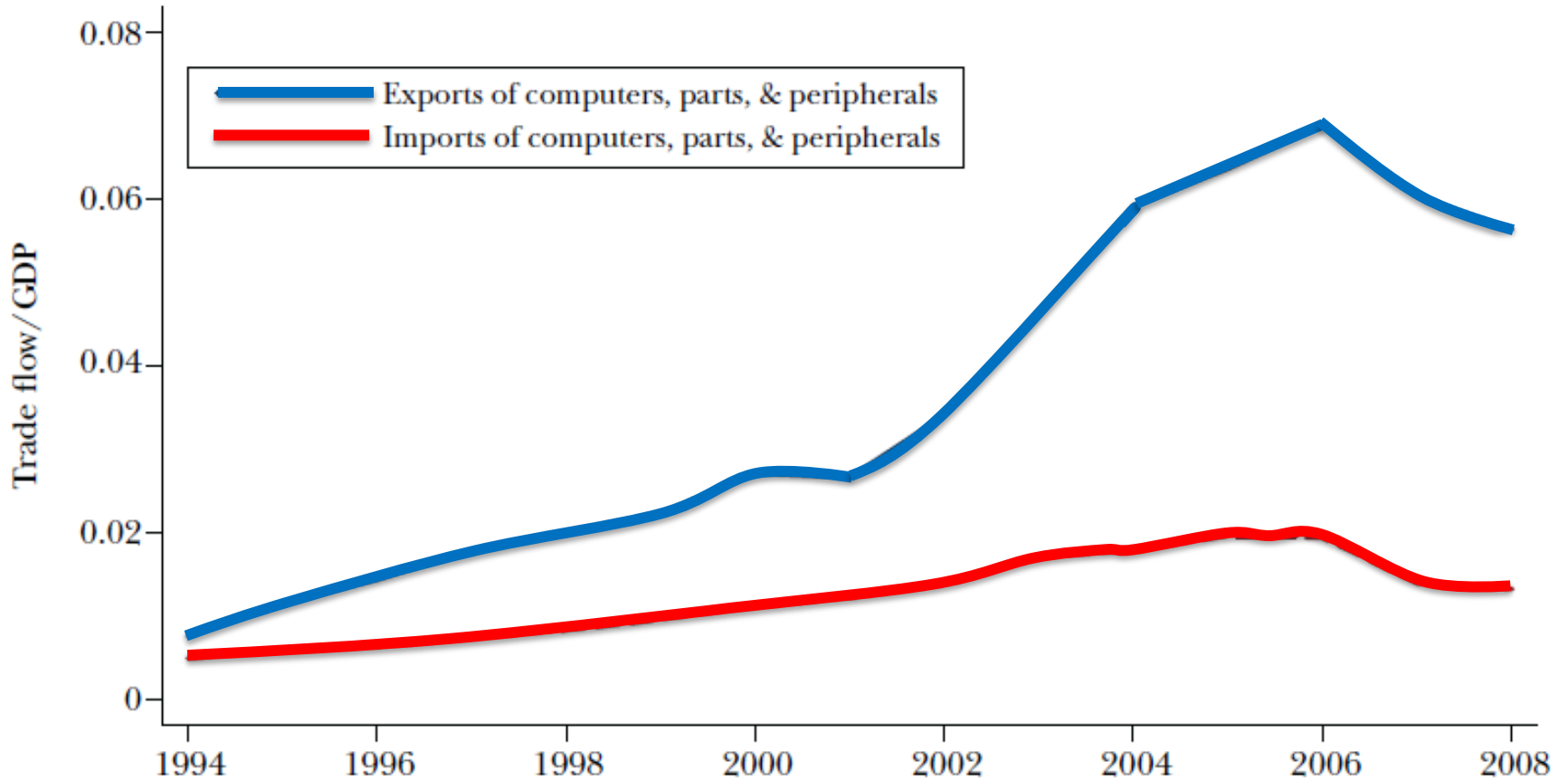


Returns to Education in Urban China





China's Imports and Exports of Computer Parts





- **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**