The Economist

China's labour market

The next China

As the supply of migrant labour dwindles, the workshop of the world is embarking on a migration of its own

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THE angrier they become, the less intimidating they seem. The strikes, stoppages and suicides that have afflicted foreign factories on China's coast in recent months have shaken the popular image of the country's workers as docile, diligent and dirt cheap. America's biggest labour federation, the AFL-CIO, blames imports from China for displacing millions of Americans from their jobs. But in June its president applauded the "courageous young auto workers" who waged a successful strike at a Honda plant in Foshan demanding higher wages.

While foreign unions cheer, multinational companies fret. According to UNCTAD, foreigners have invested almost $500 billion in China's capital stock. Their affiliates employ about 16m people in the country. For a decade this combination has dominated global manufacturing growth, dispatching ever cheaper goods from China's ports. Of China's 200 biggest exporters last year, 153 were firms with a foreign stake. But the recent unrest has put Chinese labour at odds with foreign capital.

Firms may have to get used to bolshier workers. The number of young adults is set to shrink, which is likely to make China's factory boys and girls harder to please. But then, as the AFL-CIO points out, China's workers are due a pay rise: their share of national income has fallen in the past two decades, contributing to China's low rate of consumption. As pay goes up the country's domestic market will become more lucrative. Foreign firms that came for the workers will stay for the shoppers. China will become more of a workshop for itself and less of one for the world.

The workers are revolting

Labour unrest in China is more common than you may think. The country's courts handled more than 280,000 labour disputes in 2008, according to *Outlook Weekly*, an official magazine. It is difficult to know if unrest is growing, but the government at least seems to think so. The same source reports that disputes in the first half of 2009 were 30% higher than a year earlier. Guangdong, a favourite province for foreign companies, suffered at least 36 strikes between May 25th and July 12th, according to *China Daily*, a government newspaper.

As students of Karl Marx and of history, China's party leaders will know that labour movements can begin with economic grievances and end in political revolt. By concentrating people in one place, Marx argued, factories turn a crowd of strangers into a "class": conscious of its interests, united with each other and against the boss. But workers in China's coastal factories have hitherto shown little class-consciousness. They migrated from all over the country, jumped from one plant to another and retreated to their villages when times were bad.

Their new assertiveness may reflect a labour law introduced in January 2008, which gave workers more contractual rights. The strikers at Honda were better educated than the average rural migrant and also trained together, which may have given them the social glue to organise their protest. The malcontents may also represent a generational shift among migrant workers.

According to John Knight and Ramani Gunatilaka of Oxford University, they no longer compare their lot with the rural folk they left behind, but aspire to urban standards of living.

The strikers have also taken advantage of the government's willingness to indulge nationalist sentiment. The police are far less likely to charge at you with batons if you strike in a Japanese-owned factory rather than one owned by the state. At Honda the workers complained that their wages were disproportionately lower than those of their foreign managers. "Aren't Chinese as good as the Japanese?" one asked. Though any form of protest worries party officials, they have not tried to crack down on the recent unrest in foreign-owned enterprises. As workers shouted their grievances to journalists at the gate, police kept their distance.

China has the world's largest manufacturing workforce: more than 112m people at the end of 2006, according to Erin Lett, formerly of America's Bureau of Labour Statistics, and Judith Banister of the Conference Board, who include enterprises in China's towns and villages, where 70% of its metal-bashers work. This workforce is still cheap, costing $0.81 an hour, by the authors' estimates, or just 2.7% of the cost of their American counterparts.

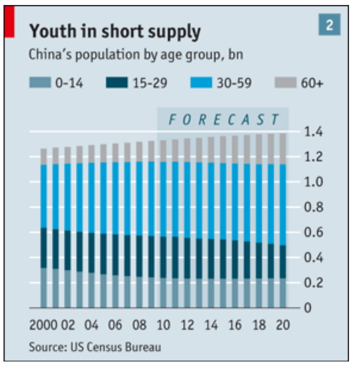
But it is not as cheap as it was. Workers' compensation rose by more than 9% a year in dollar terms from 2002 to 2006, according to Ms Lett and Ms Banister, and by over 11% in the cities. A new study by Dennis Tao Yang of the Chinese University of Hong Kong, Vivian Chen of the Conference Board and Ryan Monarch of the University of Michigan suggests that Chinese workers, in the cities at least, are now as expensive as their Thai or Filipino peers.

Lately strikers in Guangdong have done even better. Those at Atsumitec in Foshan, which supplies gear parts to Honda, returned to work on July 22nd with a pay rise of 47%. Several cities have raised the minimum wage by up to 20%. Ministry of Agriculture data say that migrants' wages rose by a sixth last year, to 1,348 yuan ($197) a month (see chart 1).

These rapid advances may be no more than a post-crisis blip, retrieving ground lost during the worst months of the global recession, when minimum wages were frozen, 670,000 labour-intensive factories shut down in the coastal cities of Guangzhou, Dongguan and Shenzhen, and 25m migrants lost their jobs. But they may also be a taste of things to come. A number of economists believe China has reached a turning-point in its development, having exhausted its supply of surplus labour. Others think this conclusion premature. Calculations by Mr Knight, Deng Quheng of the Chinese Academy of Social Sciences and Li Shi of Beijing Normal University imply there are still 70m people in China's villages who might be expected to leave in search of work, given their age, family obligations and so forth.

Mr Knight and his co-authors suggest that the labour market may still be "segmented", so that a surplus of labour in the countryside can coexist with shortages on the coasts. China's land policies and its household-registration system, or *hukou*, may be partly to blame. Villagers risk losing family plots if they do not tend them. At the same time, they cannot enroll their children in city schools or benefit from many other public services until they have been officially acknowledged as permanent urban residents. That can take years.

Policy aside, people over 30 are much less likely to shoulder their bindle stick and seek their fortunes. Having risen for the past decade, the number of Chinese aged 15 to 29 will fall quite sharply after 2011, according to the United States Census Bureau (see chart 2). The drop is already evident in university applications, which have declined for two years in a row, notes Stephen Green of Standard Chartered.



The workshop of the world, in other words, is ageing. As China's villagers grow older, coastal factories will have to offer higher wages to tempt them to migrate. One-sixth of non-migrants say they are too old to go, even though they are under 40. The end of surplus labour is not an event, but a process. And that process may already be under way.

Pay versus production

How much damage this will inflict on the competitiveness of China's manufacturing depends not only on how much the workers are paid, but also on how much they produce. From 1995 to 2004, for example, labour costs in China's bigger firms tripled, according to a study by Ms Chen, Bart van Ark, also of the Conference Board, and Harry Wu of Hitotsubashi University. But labour productivity more than quintupled. The result was that unit labour costs fell by 43%. Chinese manufacturing became more competitive, not less.

But repeating that trick will not be easy. Insofar as they can be tracked, China's unit labour costs have risen more often than not in the past five years, thinks the World Bank (see chart 3). That is starting to show in the notorious "China price", which once undercut all rivals. Between the summers of 2006 and 2008 the prices Americans paid for imports from China rose by 6%. They fell during the crisis, but are rising again. That may leave room for lower-wage countries to enter industries China is graduating out of.

Vietnam, for example, is often touted as the next China. Its stock of foreign direct investment has tripled since 2000 and its exports have quadrupled. In July Hoya, a Japanese maker of optical glass, announced a $146m factory near Hanoi to make the glass substrates from which hard disks are fashioned. Intel is due to open a $1 billion plant, assembling and testing silicon chips.

Vietnam is cheap: its income per person is less than a third of China's. But its pool of workers is not that deep. Strains are already showing in its labour market. Workers downed tools 95 times in the first three months of this year. The Communist Party has decreed double-digit pay rises and firms are grumbling about a new labour law. Vietnam is not perhaps the sanctuary from strife that firms fleeing China's coasts might wish for.

The next China may instead lie closer to home: within China's borders, but away from its coasts. Three inland provinces are wooing Foxconn, the Taiwanese electronics company which raised pay in its coastal plant after a string of suicides by workers. Another, Anhui, is only a few hundred kilometres up the Yangzi river from Shanghai, but its income per person belongs to another realm. Foreigners invested $3.8 billion in the province last year, pursuing cheaper land and labour.

Unilever, which moved production from Shanghai to Anhui's capital in 2002, said in April that it would increase its investment in the province by $103m. More telling, perhaps, is the arrival of firms from Guangdong, such as Midea, an electronics firm, and Konka, a television-maker, which bought a refrigerator factory. Anhui's home-grown champions, such as Chery Auto, are also expanding. Heli exports forklift trucks to over 40 countries. Last year the province's economy grew faster than those of its more celebrated coastal neighbours (see chart 4).

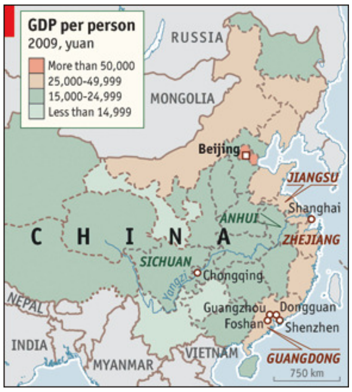
Worthy of her hire

The interior has demographic depth: Anhui alone has a population of 62m, about three-quarters of Vietnam's (although about a fifth of its labour force already works outside its borders). Provinces farther west are even bigger: Sichuan has 82m people. How far upriver might Chinese manufacturing travel? Over 2,500km from Shanghai, where the brown Yangzi meets the greener waters of the Jialing river, the city of Chongqing is flourishing. It is the centre of a municipality of 28m people, run directly by the central government. The municipality's GDP grew by over 19% in the year to the first quarter.

Chongqing's residents describe it as a "vertical city", its hilly topography accentuated by the skyscrapers above and the deep pits below, where the foundations of new towers are being laid. The city's best-known skyscraper, named the New York, New York tower, pays homage to the Chrysler building. But Chrysler itself is now second to a Chongqing carmaker: Chang'an Automobile sold 1.9m vehicles last year compared with Chrysler's 1.3m.

In January Hewlett-Packard (HP) made its first laptop in the municipality, where it has built ten production lines. The company says it was attracted by Chongqing's forward-looking government, among other things. The municipality's growth also owes a lot to a steady feed of state-backed investment. Many of its manufacturing firms trace their origins to China's defence industry, which Mao Zedong moved inland to make it harder to bomb. It also benefited from last year's stimulus spending and the government's "Go West" campaign of tax breaks and infrastructure projects, which is now ten years old.

But Chongqing remains more attractive as a gateway to inland China than as a workshop to the world. According to Bo Zhiyue and Chen Gang of the East Asian Institute, 90% of its industrial output is sold domestically. In the interior, cheaper labour is soon overshadowed by costly logistics, argue Zeyan Zhang of the University of Sydney and Miguel Andres Figliozzi of Portland State University. China's seaboard ports are impressive. But it still lacks a national trucking service, leaving companies at the mercy of a patchwork of provincial and local operators.



Sold up the river

Just over half of the 270 companies surveyed last year by the American Chamber of Commerce in China have a presence outside the country's established hubs (the Bohai region, including Beijing; the Pearl river delta, which encompasses Shenzhen; and the Yangzi river delta around Shanghai), but only 17 did so to take advantage of lower costs. HP sees its Chongqing plant as a way to get closer to its inland customers.

Chongqing's government is doing its bit to improve its links with the rest of China. To enter the city from HP's plant in the rural periphery, cars traverse a 3.8km tunnel through a mountain. The government is quadrupling the size of its main airport and a high-speed railway will eventually connect to Shanghai. And HP benefits from a special express postal service to 375 cities and counties in western and central China.

Coastal exporters interviewed by Ms Zhang and Mr Figliozzi complained that western boomtowns were competing with them for men and materials. Trade between the coast and the inland provinces was crowding out trade between the coast and the rest of the world. Trucks carry goods inland, but return empty.

The redrawing of China's industrial map may, therefore, contribute to a rebalancing of its economy. The rise of the inland provinces will push up demand for labour, even as China's baby-bust reduces supply. As a consequence, wages will rise at the expense of profits and China's workers will take home a greater share of the national cake. This will add to households' spending power and erode China's high saving rate, the sharp rise of which owes a lot to corporate tight-fistedness. According to Bai Chong'en and Qian Zhengjie of Tsinghua University, the corporate saving rate rose from 16% of GDP in 1997 to about 23% in 2004, where it has remained.

Higher consumer spending will increase demand for services, such as housing, retailing and haircuts, which consumers favour, and which cannot be traded across borders. The rise in their price will have much the same effect as a stronger exchange rate, making Chinese goods pricier relative to internationally traded commodities. As a result, China's trade surplus will shrink along with its saving rate. Arthur Kroeber of GaveKal Dragonomics calls it natural rebalancing.

This rebalancing will benefit China, which relies too much on heavy investment for its growth. It should also benefit the world economy in its present predicament. Private spending in the rich world is weak; government spending is out of fashion; and interest rates are as low as they can go. Extra demand is welcome.

Worthy of her hire

China cannot rescue the world economy on its own. Its consumer spending amounts to only 13% of American GDP, for example. And only some of the stuff its better-paid workers buy will come from the moribund rich world. But back-of-the-envelope calculations suggest that if Chinese consumption rose by, say, 20% and $25 billion of that were spent on American goods, it might create more than 200,000 American jobs, many of them in the manufacturing industries that fear China the most. No wonder the AFL-CIO is pleased.

As costs rise, some economists worry about a new Chinese export: inflation. Between 1997 and 2005 the price of Chinese exports to America fell by more than 12%. What if that trend is now reversed? In principle, the China price can rise or fall without any effect on inflation. As long as the central bank remains vigilant, other goods will just get cheaper or dearer, leaving overall prices unchanged. In practice, however, Chinese competition probably made it easier for the Federal Reserve to contain inflation, back when containing inflation was the biggest thing on its mind. For now, though, it is low on its list of worries.

In the Ranjiaba district of Chongqing, shoppers push their trolleys around a Wal-Mart supercentre, the company's third store in the city. Young "associates" huddle around a shopping till, learning how to tally the necessaries and conveniences of life, such as the live turtles and toads on sale in the food section. It is here that the next China may be taking shape: clustered around the shopping tills of Chongqing, not the assembly lines of Shenzhen.

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