



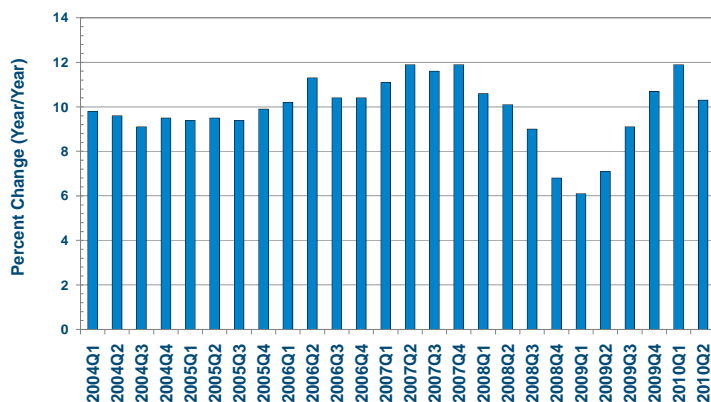
China's Rising Labor Costs and the Labor Shortage Puzzle

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After registering its slowest rate of growth since 1992, China's economy bottomed out in the first quarter of 2009 but has been expanding at a double-digit pace for the past three quarters (Figure 1). On the back of the strong domestic economy, China's labor market conditions have improved greatly. However, as global trade gradually recovered, manufacturers in the coastal area, especially in the Pearl and Yangtze River Delta regions, found it more and more difficult to find young migrant workers to help fill the export orders. The situation became even more acute in February 2010 when migrant workers, who headed for their inland hometowns for the Chinese New Year holiday, did not return to work.

Figure 1: Nominal GDP Growth in China



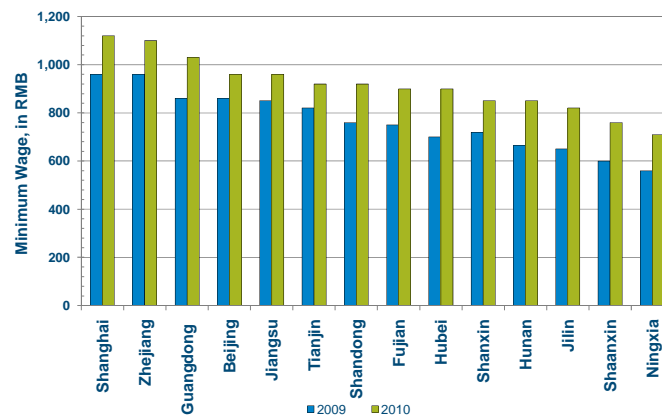
Source: Consensus Forecast

The persistent labor shortage, combined with worries over the social unrest caused by the increasingly common labor disputes, led to worker strikes demanding higher pay¹ and scrutiny due to the media coverage of the Shenzhen factory suicides.² These events pushed more than 20 provinces and cities to raise their minimum wage levels by up to 20 percent by July 2010 (Figure 2). This has raised many concerns over what impact it will have on China's export sector and whether it will lead to large-scale production relocation for multinational firms. This article offers some detailed analysis of the labor shortage conditions in China and the potential impact on its economic development.

¹ "China's Labor Market: The Next China," *The Economist*, July 29, 2010.

² David Barboza, "Electronics Maker Promises Review After Suicides," *The New York Times*, May 26, 2010.

Figure 2: Nominal Minimum Wage Across China, 2010



Source: Manufacturers Alliance/MAPI

China's Rising Minimum Wage

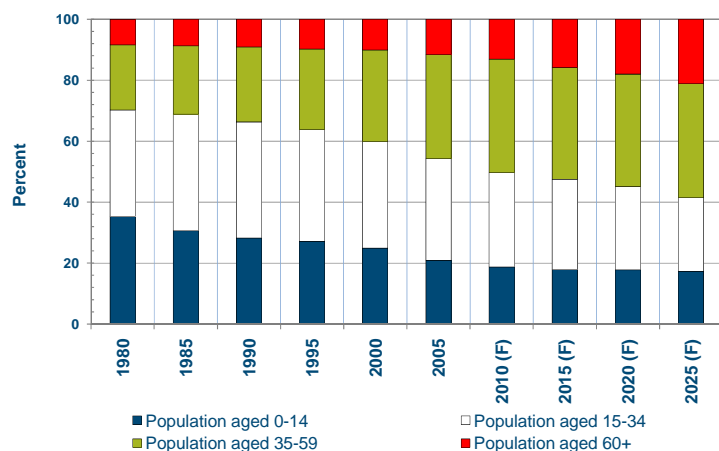
China's one-child family policy started to have an effect on the labor market in late 1990s when the share of population aged 15-29, the essential labor source for China's export industry, fell significantly (Figure 3).³ The first major "labor shortage" in China was reported in the Pearl River Delta region in 2004 when the export sector recorded more than 30 percent annual growth in 2002 and 2003. A report from the Ministry of Labor and Social Security concluded that stagnant wage growth and poor working conditions were the main reasons behind it.⁴ As a result, China set its first national minimum wage law in that year, which required local governments to raise the minimum wages at least every other year. Starting in 2006, wages for migrant workers have increased quickly, with real growth rates reaching 10 percent and 6.4 percent in 2006 and 2007, respectively.⁵ However, during the depth of the global crisis in late 2008, the government ordered a deferral of the scheduled increase in minimum wage in order to combat the recession risk when a massive layoff of about 23 million migrant workers greatly eased the labor supply conditions.

³ According to a report from the United Nations Educational, Scientific and Cultural Organization, 70 percent of migrant laborers are between 16 and 35 years of age. "Rural Labour Migration in China: Challenges for Policies", *Policy Papers/10*, 2005, Shaohua Zhan.

⁴ According to the report, the average monthly wage for migrant workers increased by less than 10 percent during 1992-2004.

⁵ "The Puzzle of Migrant Labour Shortage and the Rural Labour Surplus in China," University of Oxford, Department of Economics, *Working Paper Series No.49* John Knight, Quheng Deng and Shi Li.

Figure 3: China's Population By Age Group



Source: United Nations, Population Division of the Department of Economic and Social Affairs

The quick recovery of China's exports since mid-2009 created a huge and sudden demand for a large number of young migrant workers in the coastal area, which could not be filled in the short term. Part of this labor shortage was caused by the temporary surge in demand for low-skilled manual labor from the investment-oriented stimulus package. Millions of new jobs generated from the infrastructure and construction sectors⁶ are mainly located in the interior provinces preferred by many young rural workers since they can be closer to home. According to an official survey, in 2009, the number of migrant workers in the East declined by 8.9 percent from the previous year while the number of migrant workers increased by more than 30 percent in the Central and Western regions. In fact, economic development has been faster in the inland region than in the East in recent years thanks to the central government's support policies.⁷ The shrinking regional wage difference, the higher income for rural residents, and the fast-rising cost of living in urban areas have reduced the incentive for workers in the interior provinces to migrate to the coastal area as well (Table 1).

⁶ The total number of non-agricultural jobs created by the stimulus projects is estimated to be around 50 million. For details, "Employment Effectiveness of China's Economic Stimulus Package," *China & World Economy*, Vol.18, No. 1, 2010, Fang Cai, Dwen Wang, and Huachu Zhang.

⁷ The central government launched the West China development plan in 2000. Since 2004, the economic gap between the East and the West has narrowed. Official data shows that the industrial added value in central and western regions of the country has outpaced the growth in eastern parts since 2006.

Table 1
Number of Migrant Workers and Wage Level by Region, 2009

	East	Central	West	Total
Number of migrant workers (in millions)	90.8	24.8	29.4	145.3
Year-over-year growth rate (%)	-8.9	33.2	35.8	3.5
Wages of migrant workers (yuan/month)	1422	1350	1378	1417
Year-over-year growth rate (%)	5.2	5.9	8.3	5.7

Source: National Bureau of Statistics, China

The Labor Shortage Puzzle

The persistent labor shortage, combined with the economic recovery and inflationary pressure, had encouraged 27 provinces and cities to raise their minimum wage levels by this past July. This has intensified the debate among economists about whether China is depleting its supply of cheap labor. While some believe that China may have already achieved full employment in the course of its economic development, others argue that the current tight labor market and rapid wage gains are confined only to specific age segments (under the age of 30), and a vast ocean of unemployed or underemployed rural labor, mostly at the age of 35 and above, is still available in the countryside, the size of which is estimated to be 80 million to 100 million. A young migrant worker shortage and a large surplus in the rural area are mostly a result of China's current residency registration system, which prevents migrant workers and their families from accessing urban public services. Thus, it makes many rural workers reluctant to leave villages, at least for long periods.

While it is widely agreed that although China's rising labor costs make it inevitable for some low-end, small-scale manufacturers to relocate to other low-wage countries, foreign companies will more likely choose to set up new production bases in inland areas instead of shifting their operations out of China, given China's advantages in many other areas, including production scale, infrastructure and tax policies.⁸ In general, the wage gains are beneficial for reducing China's urban-rural income inequality, boosting labor's share in national income, and rebalancing economic growth towards more domestic consumption.

⁸ Some high-profile relocations include Intel, Foxconn, Hewlett-Packard, Quanta, and Pfizer. For details, "Labor Shortage and Higher Expenses Drive More Factories Inland China," *China Stakes*, April 11, 2010.