

The labour cost advantage and china



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Introduction

China has an emerging economy and therefore, produces many products. On the European market, there is a large demand for these products. China has relatively low production costs, which makes China an interesting country to import from. Chinese wages have risen sharply with globalization, average wages in China have increased every year since 1978. The average wage in urban areas was 21. 000 Yuan in 2006, which is four times higher than the average wage in 1995. How will the wages develop in China? The question for this research is:

Has China the labour cost advantage?

Content

Has China the labour cost advantage? 1

Introduction 2

Content 2

Offshoring in general 3

Why are companies outsourcing to China? 3

Employment in China 4

What was China's economic reason to enter the WTO? 4

How have wages been developed in China? 6

Wages by Ownership 7

Wages by Region 9

Wages by Sector 10

Wages compared with other countries in Asia 11

Has China the labour cost advantage? 12

Bibliography 13

Offshoring in general

Offshoring is defined as the movement of a business process done at a company in one country to the same, or another company, in another country. Most of the movements to lower-costs destinations take place in the own management. Outsourcing is the movement of an internal business process to an external company in the same country and the movement of an internal business process to an external company in another country. Offshore outsourcing occurs most often.[1]

Why are companies outsourcing to China?

There are different reasons why companies outsource to China, but some of these reasons are similar. Several reasons for outsourcing to China are[2]:

Cheap Labour:

China offers savings up to five times compared to the U. S. The labour costs in China are 50 percent lower than in India.

Libialization of laws and government policies:

Government has passed laws which protect private ownership and intellectual property in the country. It has also embraced public/private partnerships and domestic/foreign partnerships.

Existence of offshore manufacturing and physical proximity to major markets:

China is the manufacturing plant of the world, which provides sound base for outsourcing, strengthened by risk mitigation and greater stability.

Employment in China

Although China is still a developing country with a relatively low average income, it has a tremendous economic growth since the seventies (9.1 percent in 2004). This can be related to a great extent of an economic liberalising policy. The Gross National Product raised with 400 percent between 1978 and 1998 and the international investments grew tremendous during the nineties. The agriculture is by far the most important sector. Figures of 2007 show that 41 percent of the total population of China is employed in this sector. Nevertheless, the agricultural land limits to around 11 percent of the total Chinese land surface. Since the seventies, the agriculture is privatised, which yield a tremendous production growth.

Figure 1: Economic growth, percentage per year[1]4

What was China's economic reason to enter the WTO?

Joining the WTO is a very important event for the development of China at the beginning of the 21st century. WTO membership opens up China's market for more international trade and investment, and opens up the world

economy for China's exports. Some researchers see it as a positive force for China's economic development while others are concerned that the competition of foreign imports and foreign enterprises in China might destroy important domestic enterprises in China's agricultural, manufacturing and service sectors.

The main motivation of Premier Zhu Rongji in promoting China's entry into the WTO was to use foreign competition to speed up economic reform in both the industrial and service sectors. In the late 1990s, reform in both sectors was slow due to the inertia coming from vested interests of a group of formerly appointed managers holding on their positions.[3]

How have wages been developed in China?

Average wages have increased every year since 1978. In 2006, the average wage in urban areas in was 21. 000 Yuan, which is four times higher than the average wage in 1995.

However, as wage levels increased, so did discrepancies between different sectors, types of ownership and regions. In general, average wages were higher in share-holding, foreign-owned and state-owned enterprises, and were lowest in locally funded enterprises, with wages in enterprises owned by Hong Kong and Taiwanese businesses in the middle.

A more significant gap emerged between different occupations and industrial sectors, and especially between low-skilled and high-skilled workers. In 2006, the average wage of employees in primary industries was only 786 Yuan, which is a quarter of the average wage of employees working in

financial services (3. 273 Yuan) and one-fifth of those working in the computer industry (3. 730 Yuan).

Wages by Ownership

Between 1995 and 2007, the average annual wage for employees grew more than four times, from 5. 600 Yuan to 22. 700 Yuan. Figure 2 shows the average annual wages of staff and workers by type of ownership from 1995 until 2007. In China, there were three “ periods” of wage reform. The first period of reform started around 1985. Before this year the average wage growth was around 4. 9 percent per year. In the period 1986 until 1997, employment in jointly owned enterprises experienced a tremendous growth. The average wage growth per year was still quite low, with an average of 3. 9 percent, which was partly due to a negative growth in 1988 and 1989 (because of inflation and political upheaval).

The third period was from 1997 until 2007. From 1999 on, the average wages were rising rapidly with an average of 14 percent per year. This could be because of China’s preparation for getting into the WTO, as well as the restructuring of state-owned enterprises which started in 1998. Wages in the state sector began to increase in the late 1990s, reaching 14. 358 Yuan in 2003, surpassing private sector wages by a narrow margin for the first time since reform began. By 2007, the average wage in the state sector was about 11 percent higher than in the private sector.

The state-owned sector has been restructured in the 1990s. In the planned economy, they had low productivity, disguised unemployment (because of China’s political function of maintaining low

unemployment) and limited profits. They had a wage system which was dependent on seniority. In the 1990s, the Chinese government would not include the losses of their enterprises. This is why they began with restructuring. They started by allowing privatisation of small and medium state-owned companies. After that, the government started with a more aggressive restructuring. The objective was to shut down loss-making companies and establish modern forms of corporate governance. These reforms led to many layoffs in state-owned companies. From 1996 to 2002, around 40 million employees were laid off.

As can be seen in figure 3, the Chinese government succeeded in downsizing the employees and the productivity in the state-owned sector increased.

Figure 2: Annual wages of staff and workers by type of ownership in thousand Yuan

Source: China Statistical Yearbook

Figure 3: Employment share and labour productivity for state owned enterprises

Source: <http://www.conference-board.org/economics/workingpapers.cfm?pdf=E-0024-07-WP>

Wages by Region

Figure 4 shows the annual wage of employees divided in different regions in China. The 30 provinces are divided by the National Bureau of Statistics of China in six regions: Bohai (Beijing and surrounding

provinces), Southeast (including Shanghai, Guangdong and other coastal provinces), Northeast, Central, Southwest and Northwest China. Tibet is not listed, since there is limited information about this region. Figure 3 presents the real annual wage of employees across the six regions in China, showing the different wage patterns.

During the first period of reform, the average wages were grouped. Later on, the wages in the South-eastern and Bohai regions began to rise. As can be seen in figure 4, the wages in the South-eastern and the Bohai regions now have the highest average wages. The difference between these two regions and the other four regions is around 30 to 40 percent.

The highest growth in the past 20 years has occurred in the South-eastern and the Bohai regions, the coastal areas where cities as Beijing, Guangzhou, Shanghai and Shenzhen are located.

Figure 4: Annual wages by Region in thousand Yuan (Source: China Statistical Yearbook)

Wages by Sector

The wages by sector have about the same pattern as the wages by regions. In figure 5 the wages across sectors are showed. Remarkable is that the wages across sectors stayed clustered until 1993. After 1993, the average wages for Banking & Insurance, Scientific research & Polytechnic service increased rapidly. These two sectors are both sectors with skill intensive labour.

To make a comparison between the skill intensive sectors and the other sectors (unskilled sectors), the average wage in the construction sector was 5.729 Yuan in 1990, about 14 percent higher than the average wage for the banking & Insurance sector. In 2007, the Banking & Insurance sector had an average wage of 50.000 Yuan, around 265 percent higher than the wages in the Construction sector.

People believed that manufacturing wages grew the fastest because of the increasing volume of exports in China. Actually, these wages grew even below the national average, although manufactured products counted for more than 90 percent of China's export.

Figure 5: Annual wages by sector in thousand Yuan (Source: China Statistical Yearbook)

Wages compared with other countries in Asia

Figure 6 shows the manufacturing wages of different Asian countries from 1979 to 2007. The wages of China are comparable with the Philippines and Thailand, plausible is that the wages of Malaysia are much higher than the other countries listed.

Figure 6: Annual Manufacturing wages between several Asian countries in USD

Source: International Labour Organization

Has China the labour cost advantage?

Wages have been developed. However, there are differences between skilled and unskilled labour. The wages for skilled labour increased rapidly the past

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decade. (see page 10)Wages for unskilled labour still remains quite low compared to the skilled intensive sectors.

Reasons for the wage growth of unskilled workers are the GDP growth of more than 10 percent per year, and the export growth of almost 30 percent per year since China became part of the WTO in 2001. In contrast to this, employment in manufacturing has increased with 3 percent in recent years.

Compared to other developing countries in Asia, China still have the lowest wages on average. However, wages in China have developed rapidly since the late 1990s.

Another factor is the large supply of graduated students over the past several years. Due to an increasing demand in skilled labour, the Chinese government expanded the enrolment of students in the late 1990s. In 1998, the total number of admitted students was around 1.08 million, a number that increased to 2.68 million in 2001. This could prevent a rapid increase of the wages in the future.