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Forecasting the impact of China's labor strife



Professor Ramamurti notes that workers in China have very few rights. *Getty images.*

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China's economy has benefited from an abundance of cheap labor since the 1980s. But the recent suicides of 10 employees of electronics manufacturer Foxconn Technology and the massive strikes by employees of Honda have caused its government, and a number of companies, to increase wages for an increasingly resentful workforce. **Ravi Ramamurti**, Northeastern University distinguished professor of international business and director of the **Center for Emerging Markets**, analyzes China's labor struggles and their impact on the global economy.

Does the recent labor crisis foretell a rising labor movement in China?

Not if the government has its way. Ironically, workers have had fewer rights in Communist China than in many other countries. By law, there is only one national federation of workers, controlled by the Communist Party, and, until recently, the government was more concerned with creating jobs and attracting foreign investment than with maximizing workers' interests.

The government kept wages low and ensured industrial peace, using the police to break strikes, if necessary. This worked as long as the supply of migrant workers into the booming coastal provinces exceeded demand. But with growth booming in the interior provinces as well, the supply of migrant workers to coastal cities has declined.

The truly surprising thing is not that workers are demanding and getting higher pay—something the government itself has pushed for since 2008—but that this is a spontaneous movement led by workers, not one orchestrated by government. If it spins out of control, the government could come down hard, and things could turn ugly quickly.

How much did Chinese manufacturing workers make before the recent salary increases and what will those increases mean?

In eastern cities like Shenzhen and Shanghai, the minimum wage is about \$160 per month, but firms pay almost 50 percent more to attract workers. The average wage used to be a lot lower in the interior of the country, but lately that difference has narrowed to only 10 to 20 percent. According to press reports, Honda increased its wages by 20 percent to end the recent strike in its factory, and Foxconn increased wages by 60 percent, to \$400 per month.

While Chinese wages are still very low compared to the United States, the sharp increases will force many Western companies to rethink their sourcing strategies.

How will China be affected by the more expensive lifestyle of its workers?

The wage increases will help boost internal demand for goods and services, because Chinese workers will have more spending money, and it will reduce China's reliance on exports for growth. It will also force companies in the eastern provinces to raise labor productivity and move up the value curve to more advanced products or processes.

The bad news is that it will reduce China's international competitiveness, which was based on low wages and docile workers. Therefore, foreign companies will look to shift production to other low-wage countries, such as India and Vietnam. But this will not happen overnight, because China's sophisticated network of suppliers will be hard to replicate elsewhere, and the lower wages of these other countries will be offset by the higher costs of doing business in those locations.

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Will the wage increases affect the prices of cars, computers and other products manufactured in China?

It will certainly increase costs for companies making things in China, but they may not pass on the higher costs to U.S. consumers immediately, given the anemic state of the economy. Instead, they will settle for lower profit margins or shift production to other low-cost countries. But once the U.S. economy recovers, Wal-Mart and others will be tempted to raise prices to reflect the rising cost of doing business in China. Almost every product we buy will be affected, either because it is manufactured in China or depends on parts made there.

As a result of the salary increases in China, will other countries step in to offer the same amount of manufacturing capacity at lower wages?

The recent developments in China certainly open the door for other countries. Relatively simple products like footwear and textiles would be prime candidates for relocation to [manufacturing facilities in] Bangladesh, Indonesia or Vietnam.

In the case of more complex products, such as toys and consumer electronics, firms will move less-skilled operations to the interior provinces of China, while retaining higher-skill operations in the coastal provinces, whose links to the interior are improving by the day.

India is the only country with a big enough labor force to rival China's. But India's infrastructure is so poor that it cannot compete in really low-cost manufacturing. It does better in products that are skill-intensive, such as engineered goods, software, or pharmaceuticals, where margins are higher.

So, in the mid-term, if China ceases to be the world's low-cost workshop, we may all be in for a dose of inflation.
