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INCREASING WAGES IN CHINA: GOVERNMENT
MANIPULATION OF WAGE RATES WITHOUT DIRECT
REGULATION

by

Christine M. Westphal* and Susan C. Wheeler**

In her 2002 book, *Making Sweatshops*, Ellen Israel Rosen describes in detail the difficulties faced by workers all over the world in the apparel industry who are caught in a downward wage spiral by the "race to the bottom" in garment manufacturing. She argues that as developing countries attempt to attract international capital investment they must offer "concessions to investors designed to reduce the costs of production..."¹ most often by exploiting women workers in garment and light industrial manufacturing. She is but one among a large chorus of writers who have observed that multinational corporations "ruthlessly exploit the factors of production by chasing after ever-cheaper labor and ever laxer environmental regulations."² The push by corporations to externalize costs, so that the countries that accept their investment dollars absorb the costs of pollution, degradation of worker health and safety, and human rights violations while the corporation achieves greater profit is at the heart of the "race to the bottom."³ These problems associated with lax regulations are often made worse by a combination of bribery and corruption which renders the laws of the host country ineffective.⁴

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There has been a concerted effort to force American corporations to internalize more of these costs through corporate codes of conduct⁵ but by and large these efforts have not been successful on a large scale.⁶ Initiatives such as student anti-sweatshop drives have probably done more to alert the public to the existence of deplorable conditions than to improve the lives or wages of workers.⁷ It should be noted that this process of worker

exploitation is not simply a failure of procedural safeguards. The argument that if the "host" country had a more developed legal system workers would have an opportunity to redress their grievances and achieve safe working conditions and prosperity is actually quite hollow. Workers in the Northern Mariana Islands (a United States Territory) have suffered through the same exploitation and abuse as those in countries with a less developed legal system. The attempts to use the Alien Tort Claims Act to increase corporate accountability in the Northern Mariana Islands and elsewhere, while both admirable and interesting, have done very little to actually improve the lot of workers on the manufacturing floors of the developing world.⁸

Even though most writing on the "race to the bottom" focuses on the manufacturing floor, virtually all of the writers cited above trace the "push" propelling this "race" to the retail industry. Rosen describes this as the Wal-Mart Effect⁹ noting that "more than 70 percent" of Wal-Mart inventory originates in China.¹⁰ She cites China's "low wage labor and ... advanced technology" along with the production of "quality goods" as the factors that make it the most attractive supplier for retailers such as Wal-Mart¹¹. With the end of garment quotas by the World Trade Organization many of the experts in this area expect an acceleration of this downward spiral, and they expect China to dominate the garment trade for the

foreseeable future.¹² While there is some argument that China will dominate the garment trade because it has both "state-of-the-art factories" and a "rapidly improving transportation network"¹³ other writers simply cite China's huge labor surplus.¹⁴

China faces multiple challenges in this environment. It is committed to a course of rapid industrial development that requires huge foreign investment. In order to attract that foreign investment it must continue to demonstrate that investing in China provides competitive advantages to manufacturers and the retailers who contract directly with Chinese manufacturers, primarily by providing vast numbers of low wage workers, but those workers are increasingly dissatisfied with their wages and working conditions and are engaging protests.¹⁵ Most new manufacturing has been situated on the coast, and inland provinces are feeling neglected. Their workers migrate to the coastal regions to find work; and they provide the labor for much of the new development without actually receiving much benefit.¹⁶ These migrant workers often do not have access to government services (education, health care, etc.) because they are not considered legitimate residents of the cities where they work.¹⁷

It is clear that in order to continue to maintain political stability the Chinese government needs to sustain its growth rate, improve the working conditions and the wages of its workers, and move industrial development to the western and rural provinces. How these contradictory goals are being met by a combination of infrastructure improvements, indirect regulations and market forces is the subject of this paper.

THE ROAD TO PROSPERITY

China began to intensify planning its national highway system in the 1990's with a comprehensive highway law that sought to build 57,000 miles of roads from 1995-2000.¹⁸ The Chinese have also planned the construction of a massive expressway system comparable to the interstate highway system constructed by the United States in the 1950's and 1960's.¹⁹ They have completed over 18,000 miles of expressway in the last 15 years.²⁰ While this is still considerably less than the United States, which has 46,000 miles of interstate, the estimates are that China will overtake the United States in this area by 2020.²¹ This is particularly impressive when you consider that in 1988 China had only 11.5 miles of expressway.²²

The reasons for this massive, growing²³ investment are many. First, the Chinese seek to "connect all of the country's provincial capitals and cities with populations of over 200,000."²⁴ A further purpose is to cut travel times between cities and provinces and give the entire population access to roads and highways.²⁵ They believe that expediting transportation by the creation of a comprehensive road network will lower the transportation costs for raw materials and finished goods within China. Presently the government estimates that the transportation of raw materials and finished goods constitutes 20 percent of production costs in China (in the U.S. this represents 3% of product cost).²⁶ It has also seen an increase in tourism in cities of historical significance to the Chinese²⁷ and hopes to create the kinds of roadside enterprises that have developed in the United States (i.e. lodging, food, and fuel).²⁸

But perhaps the most important goal of this road building frenzy is to spread industrial development to the Western and rural areas of China. The estimates are that "the per capita income in the 12 Western and Central provinces is less than

half "of the income on the industrialized coast."²⁹ This translates into substantial labor cost savings for companies that relocate from the coast to inland provinces.³⁰ Road construction has been supplemented with other infrastructure improvements including airports (9 billion in the last five years³¹) and power plants.³²

For the Chinese this investment "pays off" in a number of ways. First it allows China's political leaders to deliver on the promise of its Develop the West policy; second it allows China to retain foreign investment as it raises wages³³ on the industrial coast by offering manufacturers who rely on low labor cost to retain a competitive wage advantage by moving inland, and third, it encourages workers to stay in their home areas instead of migrating to the coast. The Chinese also recognize benefits in food distribution³⁴ and as an added bonus, it helps shrink the labor force available to coastal employers.

As infrastructure improves (and wages on the coast increase) more and more western investment is flowing to the interior provinces. Fifty percent of the U.S. companies that belong to the American Chamber of Commerce in Beijing have already "invested in second-tier cities"³⁵ including multinational giants General Motors, Honda, Motorola and Carrefour (a French Wal-Mart competitor).³⁶ With labor excess in the rural sector exceeding 150 million workers,³⁷ there is every reason to believe that multinational industrial movement to and investment in China's rural areas will continue to increase.

HOW ARE YOU GOING TO KEEP THEM DOWN ON THE FARM?

This spring both Business Week³⁸ and the International Herald Tribune³⁹ ran articles on labor shortages in China. In a

country with vast labor surpluses this seems odd at best. But an examination of recent regulatory changes within China and the stated purposes of long term infrastructure improvements in the country's interior suggests that this is the result of a coordinated and well thought out process on the part of the Chinese government. If the goal of the Chinese government is to raise the wages of industrial workers in the industrialized coastal area and encourage foreign investment in the country's interior then the plan seems to be working. The first step, as outlined above, was to create the infrastructure that would allow multinational corporations to move their businesses inland. The second step is to encourage them to make the move. The "creation" of labor shortages causes market driven wage increases, as well as improved working conditions for factory workers in the industrialized coastal areas.⁴⁰ This in turn gives interior locations a significant comparative wage advantage for manufacturers.⁴¹

Li and Park in their article, "Determinants of Locations of Foreign Direct Investment in China"⁴², observe that "the traditional view of regional comparative advantages... holds that firms relocate their operations according to variations in production factors, infrastructure and economic policies..."⁴³ They conclude that the legal environment and other institutional factors such as the protection of property rights should also be given significant weight when analyzing foreign investment decisions.⁴⁴ However, they specifically cite garments and shoe manufacturing⁴⁵ as products that do not "require a high level of protection for property rights..."⁴⁶ We would suggest that this reinforces the Chinese government's strategy of encouraging the relocation of these industries to the interior provinces in China. Where there is not already significant development the additional infrastructure investments in roads and airports along with artificially created wage differentials caused by coastal labor shortages will have

the biggest "pay off" in foreign investment in garment and shoe manufacturing in the interior provinces.

The Chinese government is playing a pivotal role in creating these labor shortages.⁴⁷ Prior to the 1980's China restricted internal migration by a system of "household registration (hukou), rural commune controls, and food rationing"⁴⁸. In the 1980's the government eliminated communes and food rationing, which essentially allowed free migration within the country. While many household registration rules remained in effect, most migrant workers in China simply ignored them. While their non resident status in Coastal and industrial cities limited their access to health care, housing and education most felt that the economic advantages of "western" jobs were worth the sacrifices.

This has caused the government to create incentives in order to encourage rural workers to remain in their home provinces. The biggest changes have involved improving the incomes of farmers. In 1998 the government began giving farmers greater freedom in crop selection which has allowed farmers to move to higher-value crops.⁴⁹ It has also increased direct subsidies to farmers.⁵⁰ Finally, it has eliminated most farm taxes.⁵¹ Taken together these actions have substantially improved rural incomes.⁵² Dexter Roberts quotes a young Chinese worker in his 2005 Business Week article "Most young people in my village don't want to leave because they can make money from the land"⁵³. In addition, China's one child policy has both limited the workforce and discouraged migration. Most parents do not want their only child to "leave home"⁵⁴. The one child policy was implemented in the 1980's and these are the workers presently entering the workforce. Since "export-oriented manufacturers prefer to hire women from 18 to 25 as factory workers"⁵⁵ they are being hit the hardest by this demographic change causing them to move inland first.

Recent changes in the household registration law have also made it easier for workers to move legally to small towns and cities. As a result, young workers can stay close to home and with manufacturing jobs moving to the rural provinces and second tier cities, there is ample opportunity to find work.

MARKET FORCES

It is likely that the Chinese government is seeking to use market forces to lift wage rates for two reasons. The first, is that a government sponsored increase in the minimum wage might encourage a flight of capital investment to lower cost countries such as Vietnam or Bangladesh.⁵⁶ The second, and somewhat more complex reason is the inability, or unwillingness, of the Chinese government to enforce its labor laws. Multiple authors have cited lax enforcement of labor and wages laws as a root cause of worker unrest.⁵⁷ There have also been serious problems with bribery of local officials that the central government has recently sought to address by an across the board increase in official wages. The hope is that by paying local officials a higher salary there will be less incentive to accept bribes. Only time will tell if they can successfully combat local corruption by supporting and increasing the compensation paid to local officials.⁵⁸ However, if workers can “vote with their feet” by leaving employers who do not live up to their promises of fair wages and decent working conditions⁵⁹ then lack of government enforcement becomes moot. As Dexter Roberts pointed out in his 2006 article for *Business Week*, labor shortages will cause high worker turnover rates unless multinational corporations raise wages and improve working conditions.⁶⁰

It is estimated that a 10% increase in average income reduces poverty by 19 to 39 % in China.⁶¹ Labor shortages in

the industrialized coastal region are causing market forces to drive up wage rates. While there are serious questions about China's labor statistics⁶² and cheery government reports of 14% annual average wage increases seem optimistic⁶³ it is clear that China's workers are making economic progress. The World Trade Organization estimated that China had cut “poverty from 73 percent in 1990 to 32 percent in 2003.”⁶⁴ Increases in rural income over the last few years have lowered it further.

In places like Shanghai many companies are paying low skill workers significantly more than the minimum wage.⁶⁵ Access to TV sets, e-mail and cell phones has created an awareness of both “rights” and opportunities for Chinese workers⁶⁶ and a more vibrant and mobile labor force. With many coastal employers unable to meet their employment goals “voting with their feet” is now a real option for manufacturing workers in the industrial coastal areas.

Since most multinational manufacturers are paying more than the minimum wage it is then possible for local governments to raise the minimum wage without disrupting the flowing of international investment. Shenzhen, one of China's special economic zones, recently raised the local minimum wage by 23% without adverse impact.⁶⁷ This kind of trailing regulatory activity where the government manipulates the available number of workers to force a market driven increase in wages, and then raises the official minimum wage to a level just below the new market wage has both public relations value and economic value.

From the public relations perspective, the government can claim to be protecting Chinese workers from exploitation by multinational corporations. This has also allowed China's government sponsored union, The All-China Federation of Trade Unions (ACFTU), to achieve a higher profile by publicly

calling for increased wages. In the longer term it seems likely that the government will push the ACFTU into multinational corporations doing business in China in order to allow for more government and communist party influence on wage and employment practices without the use of either direct or indirect legislation or regulation.⁶⁸

From an economic perspective, increasing the minimum wage in coastal industrialized areas further enhances the comparative labor cost advantages of rural provinces and the wage increase on the coast will help create a larger Chinese middle class.⁶⁹ It is this growing class of Chinese consumers that multinational corporations find irresistible. Many companies are committed to future expansion in China and this expansion potential makes them reluctant to leave China for other low cost countries in the region. Wal-mart, in particular, has placed great emphasis on future expansion in China and seems unlikely to anger the Chinese government by "outsourcing" to other developing countries.⁷⁰

CONCLUSION

Faced with a need to both attract foreign investment and increase worker prosperity China has engaged in a systematic process of creating labor shortages in its highly industrialized coastal areas in order to induce market driven wage increases. By manipulating the labor markets on the coast and providing infrastructure support they have managed to "encourage" manufacturers who are seeking low wage workers to move their factories (and investment capital) inland. This has had many benefits from the Chinese perspective and at least on its face has very little down side.

This is not to suggest that success is assured or that Chinese development and labor practice are trouble free.⁷¹ But

certainly this piece of regulatory manipulation appears to be successful.

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³ Canova, at 5.

⁴ Minxin Pei, *The dark side of China's rise: China's economic boom has dazzled investors and captivated the world. But beyond the new high-rises and churning factories lie rampant corruption, vast waste, and an elite with little interest in making things better. Forget political reform. China's future will be decay, not democracy*, *Foreign Policy* 153 (March-April 2006): 32(9).

⁵ Larry Cata Backer, *Multinational Corporations, Transnational Law: The United Nations' Norms on the Responsibilities of Transnational Corporations as a Harbinger of Corporate Social Responsibility in International Law*, 37 *Colum. Human Rights L. Rev.* 287 (2006).

⁶ Robert J. Liubicic, *Corporate Codes of Conduct and Product Labeling Schemes: The Limits and Possibilities of Promoting International Labor Rights Through Private Initiatives*, 30 *Law & Pol'y Int'l Bus.* 111 (1998). See also Karen M. Smith, *Note: Solving Worker Abuse Problems in the Northern Mariana Islands*, 24 *B.C. Int'l & Comp. L. Rev.* 381 (2001) (discussing voluntary codes of conduct for manufacturers in China and elsewhere).

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⁸ Deborah J. Karet, Privatizing Law on the Commonwealth of the Northern Mariana Islands: Is Litigation the Best Channel for Reforming the Garment Industry?, 48 Buffalo L. Rev. 1047. See also Douglas S. Morrin, Book Review: People before Profits: Pursuing Corporate Accountability for Labor Rights Violations Abroad Through the Alien Tort Claims Act, 20 B.C. Third World L.J. 427 (discussion of possible uses of the Alien Tort Claims Act).

⁹ Ellen Israel Rosen, International Law Symposium: Article: The Wal-Mart Effect: The World Trade Organization and the Race to the Bottom, 8 Chap. L. Rev. 261.

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¹¹ *Id.*

¹² *Id.* at 282. See also Hildegunn Kyvik Nordas, Staff of the WTO Secretariat, Discussion Paper No 5, The Global Textile and Clothing Industry post the Agreement on Textiles and Clothing (2004).

¹³ George Wehrfritz and Alexandra A. Seno, *Succeeding at Sewing*, Newsweek: International Edition, January 10, 2005, at 1.

¹⁴ Ray Brooks & Ran Tao, China's Labor Market Performance and Challenges (IMF Working Paper Asia and Pacific Dept., WP/03/210, 2003) at 3.

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¹⁹ Calum MacLeod, *China's Highways Go the Distance; Expressways Pave the Way for Change*, USA Today, January 30, 2006 Final Edition at 6A. See also Robyn Meredith, *When the Silk Roads Gets Paved*, Forbes, 174 (5) September 20, 2004, at 111.

²⁰ Meredith, *supra* note 18.

²¹ MacLeod, *supra* note 18.

²² *Id.*

²³ Interview by Derek Jiang, AFX News Ltd. AFX – Asia, with Dong Xuebo, Head of the Planning Dept. at the Ministry of Communications, (Sept. 29, 2005). Investment increased at a rate exceeding 23% percent annually from 1998 to 2004.

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²⁵ *Id.*

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³³ *Id.*

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³⁵ Roberts, Go West, *supra* note 30.

³⁶ *Id.*

³⁷ Brooks & Tao, *supra* note 13.

³⁸ Dexter Roberts, *How Rising Wages are Changing the Game in China; A labor shortage has pay soaring. That is sure to send ripples around the globe*, Business Week, March 27, 2006 at 32.

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⁴¹ Roberts, Go West, *supra* note 30.

⁴² Shaomin Li & Seung Ho Park, Determinants of Locations of Foreign Direct Investment in China, 2 Mgmt. & Org. Rev., March 2006, at 95.

⁴³ *Id.* at 97.

⁴⁴ *Id.* at 114-15

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⁴⁶ *Id.*

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⁵² Chinese policy to concentrate on helping rural workers, *supra* note 44.

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⁷¹ For a comprehensive discussion of problems facing the Chinese government see Minxin Pei's "The dark side of China's rise: China's economic boom has dazzled investors and captivated the world. But beyond the new high-rises and churning factories lie rampant corruption, vast waste, and an elite with little interest in making things better. Forget political reform. China's future will be decay, not democracy," in Foreign Policy 152 (March-April 2006): 32(9).

THE STAKEHOLDER MOVEMENT AND THE SOCIAL
RESPONSIBILITIES OF CORPORATIONS:
A COMPARATIVE INTERNATIONAL PERSPECTIVE

by

Roy J. Girasa*
Richard J. Kraus**

One program that played a central role in our [Chase Manhattan Bank's] cultural revolution was the Corporate Social Responsibility Program. Few companies in the 1970s made charitable contributions, and still fewer had programs whereby a panned percentage of annual earnings were contributed to charity....My [David Rockefeller, CEO of Chase] rationale for an active corporate responsibility program was simple: Businesses could not afford to become isolated for the larger society of which they were an integral part....Any business that does not respond creatively to this world and its growing insistence on an improved quality of life is cutting off its future nourishment. For, however, you interpret its role, the corporation depends on

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