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THE MANY FACETS OF CHINA'S RISING WAGES
L'AUMENTO DEI SALARI IN CINA

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Abstract

Nel corso delle ultime due decadi si è assistito ad un notevole aumento dei salari in Cina. Questo elaborato mira a valutare l'entità e le caratteristiche di tale fenomeno oltre che a individuare i principali fattori che ne sono alla base. L'obiettivo non è solo quello di analizzare gli effetti dell'andamento dei salari sulla competitività della Cina nell'ambito del commercio internazionale, ma anche quello di indagare l'impatto avuto da tale aumento sulle condizioni di vita dei lavoratori appartenenti alle fasce sociali più svantaggiate.

Introduction

In a few decades, China experienced an extraordinary industrial development and economic growth, becoming the world's largest manufacturing power. According to The Economist (2015), after displacing the USA in 2010, China now accounts for almost a quarter of global manufacturing, a result which is even more remarkable considering that China only contributed for three percent in 1990. Great part of this economic miracle finds its roots on the competitive advantage assured to China by its extremely cheap, large and supple workforce, which attracted large flows of foreign investments. Nevertheless, the advantage granted by low labour costs seems to be at risk. Many enterprises, especially the ones located in the more industrialised coastal provinces, are dealing with soaring costs due to diverse causes, such as stricter environmental and safety regulations and increase in land prices. Yet, the major threat is represented by rising labour cost. After remaining stagnant at very low levels for many decades, both in terms of purchasing power and in comparison with labour productivity, wages finally started to increase at an utterly fast pace in the last years. Many studies already investigated the magnitude of this complex phenomenon and its causes. Between them, "The End of Cheap Chinese Labor" (Li et al, 2012) provides a noteworthy analysis of the positive trend followed by average wages in China between 1978 and 2009. The authors bring evidence of the fact that Chinese labour is becoming more expensive not only in nominal terms but also with regard to productivity and in comparison with other neighbouring developing countries, such as Indonesia, Thailand, India and the Philippines. Li and colleagues detect three likely explanations for the above-mentioned phenomenon: the institutional reforms, the loss of the "demographic dividend" and the slowing rural-urban migration, which is to some extent a consequence of the former two.

This dissertation contributes to their branch of research in various ways. First, it updates their study, covering the entire period between 1978 and 2014. Second, it includes the mounting labour unrest among the main factors driving the recent increase of wages. Third, it highlights which is the impact of the analysed phenomenon on the country's international competitiveness and on the living conditions of the weakest strata of Chinese society.

The study is organised as follows. The opening section provides a brief overview of China's historical and social background, which shaped the highly unusual Chinese labour market. This choice was motivated by the fact that it is not possible to undertake a study focused on the dynamics affecting Chinese wages without having in mind a clear picture of the peculiar economic environment where these events are taking place. Drawing on official data released by the National Bureau of Statistics of China, section two assesses the magnitude of the positive trend followed by Chinese average wages between 1978 and 2014 and compares the evolution registered by the analysed variable in different strata of industry, sectors and enterprises' state of registration. Besides, it also describes how and to what extent migrant workers were affected by the overall wage increase. As predictable, presenting a detailed analysis on this topic is a particularly difficult task, being migrants workers usually scarcely represented in the official statistics. Section three is reserved to the description of the main factors driving Chinese rising wages. The selected agents comprehend institutional reforms, demographic transition and widespread labour unrest. Finally, section four focuses on the tight interplay between widening income inequality and economic growth in China and discusses the possible evolution of Chinese economic model in the near future.

It is important to highlight that this brief study has been limited by a number of difficulties concerning data availability and accuracy, see Fang et Al (1998) along with Goodkind and West (2002) to have a detailed description of the issue.

1. Key factors shaping China's labour market

Before trying to detect which elements triggered the recent wage increase, it is fundamental to understand which dynamics concurred in keeping wages so low in the past. As could be expected, this represents an utterly arduous challenge, as many of these factors are highly intertwined with each other and in large part ascribable to the communist experience. Yet, there are several agents whose effects can be partially isolated and analysed, such as the *hukou* system, which is strongly related with the massive legal and illegal rural-to-urban migration waves and the dramatic lack of rights and inequality affecting many millions of workers.

1.1 Historical background: Chinese economy during the pre-reform era

After being founded in 1949, People's Republic of China had to endure the deleterious consequences of both the second Sino-Japanese war (1937-1945) and the internecine strife between the factions loyal to the Communist party and the ones loyal to the Nationalist party, which afflicted the country for over twenty years. As can be expected, the economic growth of the new-born republic was hindered by high inflation and dramatic lack of infrastructures. Nevertheless, the basis for development had already been laid: literacy rates were increasing, a small University system had been created and some modern industrial and transport capital could serve as a nucleus for further development. Moreover, thanks to the confiscations of many factories occurred during the war, the Nationalist government was endowed with a large industrial stake, with almost two thirds of modern industrial capital under central control (Naughton, 2007). After 1949 this infant state-run economy was taken over by the Communist Government, whose intervention relied heavily on the imposition of a soviet-model economy, organized around annual five-year plans, based on central control over prices, input allocation and products and founded on diffuse State ownership. Evidently, the final purpose was the boost of industrial growth, through the increase of domestic savings, mainly by redirecting resources from the rural sector (Brandt and Rawsky 2008). Chinese economic model was not an exact copy of the soviet ideal, in fact it relied less on complete centralization, conferring more authority to local bureaucracy. This peculiar economic pattern conveyed mixed results. On the one hand, also thanks to technological support coming from other countries of the Socialist-bloc, China underwent an unusually fast industrialization process and registered an impressive GDP growth, outperforming the ones of other populous developing countries such as Brazil, Egypt, India, Indonesia, and Mexico, often by substantial margins (Morawetz, 1978). On the other hand, several PRC government reprehensible policies led to the Great Leap Forward, "one of the worst catastrophes the world has ever known" (Dikötter, 2011). Although it is very difficult to formulate an exact estimation, a number of scholars, including the Hong Kong-based historian Frank Dikötter, argue that during Mao Zedong's attempt to turn China into an industrial giant, up to 45 million people were beaten, starved or worked to death. The "Great Leap Forward" was enforced between 1958/59 and 1961, with the aim of shifting from an agricultural economy to a modern and industrialised socialist state. Chinese government expected to accelerate the industrialization process, thanks to a dramatic increase in agricultural productivity after the collectivization of the rural sector. Therefore, private farming was violently banned and insanely high grain procurement standards were imposed on peasants, who were not even granted with enough calories to sustain their work. This objectionable policy provoked widespread famines and the collapse in grain production. The great Chinese famine

was the consequence of the structural failure and blindness of the government central planning, as proved by some pieces of evidence showing that rural mortality rates were *positively* correlated with per capita food production, a peculiar pattern normally very uncommon in famine spells (Meng et al, 2015). Obviously, this foolish plan also had a negative impact on overall economic growth, with the period between 1959 and 1962 being the worse years of economic regression in the entire spell between 1953 and 2015 (Figure 1).

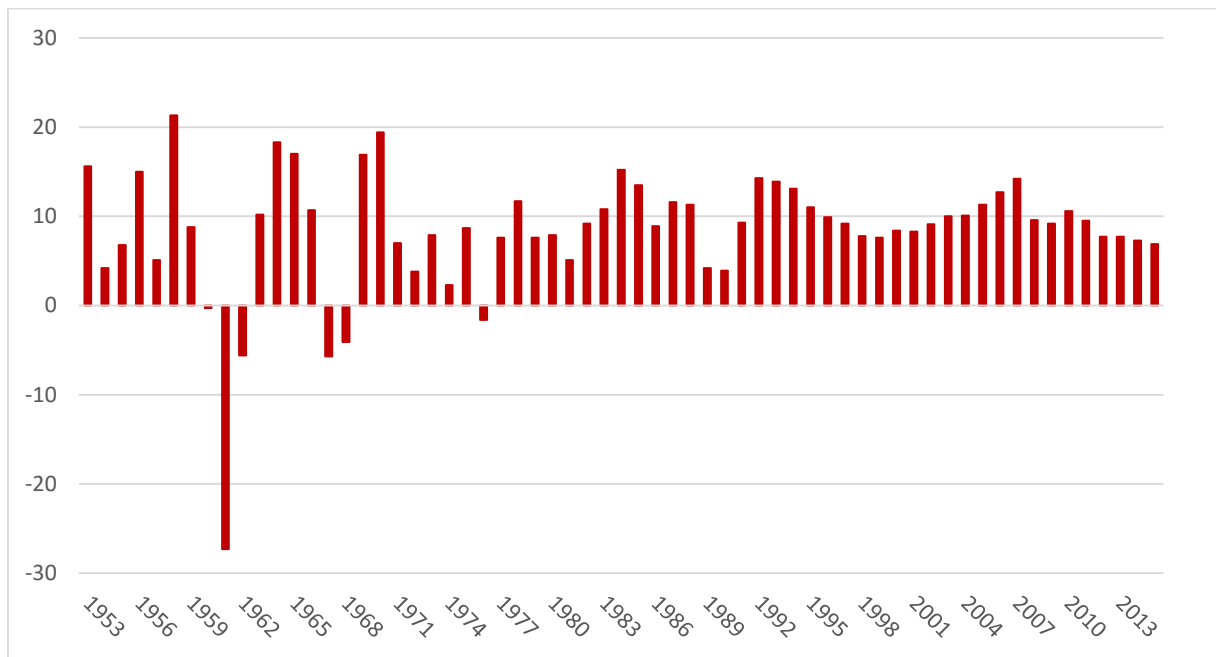


Figure 1. Annual percentage growth of China’s real GDP

Data source: Chinese National Bureau of Statistic (2016)

After the evident catastrophic failure of the Great Leap Forward, Mao was temporarily excluded from the head of the government. Nevertheless, he sought to regain his power by purging not only the party, but also the whole country and establishing a personality cult with the launch of the so-called “Great Proletarian Cultural Revolution” in 1966. He mobilized the masses to attack the communist party and every person guilty of betraying the revolution and being a capitalist bourgeois, while large groups of militant students were reunited into paramilitary units forming the “Red Guards”. The revolution threw China into turmoil and disarray with millions of people being persecuted and abused all over the country and up to 17 million students from the “privileged urban youth” forced to move in the rural regions in order to be re-educated as a consequence of the “Up to the mountains and down to the countryside movement” (Buckley Ebrey, 2005). The fact that these boys and girls were precluded from attending Universities, had obviously an impact on their career prospects after the end of the revolution, generating a so-called “lost generation”. The death of Mao in 1976 signed *de facto*

the end of the revolution, which killed one million people and wrecked the life of many more millions of individuals, causing widespread political chaos and greatly disrupting the economy. With Deng Xiaoping China finally inaugurated a new era of reforms, gradually dismantling those policies that maintained for many years a very poor, stagnant, centrally-controlled, vastly inefficient, and relatively isolated economy.

1.2 Hukou system and internal migration

The *hukou* system is an utterly complex administrative household registration regulation, established under the communist regime in the early 1950s. Formally, it was introduced to serve three purposes: government welfare and resources distribution, internal migration control and criminal surveillance. It is common practise among western scholars to simplify the *hukou* by identifying only two categories: urban and rural status. In reality things are much more complex as the *hukou* is actually composed by two different classifications: the residential location which refers to urban or rural residence and the socio-economic eligibility which results in agricultural or non-agricultural status. The strong impact of the *hukou* on the labour market and more in general on people's life, derives from the fact that the *hukou* status defines the person's right for many activities and the access to Welfare on a specified locality (Fan, 2008). For instance, in the period when major daily necessities were rationed, the supply of primary goods was based on the *hukou*, while many types of urban jobs were reserved to local *hukou* holders only for a long time (Cheng and Selden 1994). Considering the major role played by the system, it is arguable that the industrialization strategy and the *hukou* were the real central pillars of the Maoist model, whose strategy could not have been implemented without the registration system (Chan and Zhang 1999). In fact, the *hukou* responded to the Government's top priority: boosting the industrial sector in an agrarian economy afflicted by a severe scarcity of capital. By controlling citizens' geographical mobility through a system of migration permits and enrolment certificates, it ensured a flexible supply of low cost workers to the growing state owned enterprises.

The household regulation system underwent an impressive process of control tightening over the years. As a result, the procedure for the *hukou* conversion, necessary for legal permanent migration, is an incredibly long and complicated process, which requires the submission of many documents and the respect of various eligibility criteria and annual permission quotas, all of which can vary from province to province and from one year to the other. It comes without saying, that the system was harshly criticized both by Chinese intellectuals and international

community for its lack of transparency and for placing state's economic goals before people's freedom. Nevertheless, despite the very strict regulation mentioned above, the *hukou* has been much less effective in blocking migration flows than it is believed by the majority of Western scholars. In fact, it was unable to stop the inexorable waves of rural migrants, defined as "floating population", which invaded the industrialised cities during the 80s in search for an occupation (Chan and Zhang, 1999). Prior to the reform era, migration flows were limited, not because of the *hukou*'s restrictions themselves but because of its interplay with other institutions. During that time, the state exerted a strict control over every economic activity, from job recruitment to the distribution of essential goods, thus it was very difficult to survive outside the legal *hukou* without the possession of the necessary documents. With the implementation of a market oriented economy, the *hukou* lost a great part of its power, as people were no longer completely subjected to the state control, being now possible to find an occupation and primary goods on the market. The idea of a "floating" population is a unique concept, which can be only found in China, as it is based on the notion that the *hukou* location is where one individual belongs and that migration is not considered official and permanent until the migrant's *hukou* location is also changed (Goodkind and West 2002). To summarize, the official change of *hukou* is the discriminatory element which distinguishes *temporary* migrants, who constitute the so-called floating population, from *permanent* migrants – *qianyi* – and this has nothing to do with the actual length of the migration spell. The Chinese Statistical Yearbook (2015) defines it as "*the population of residence-registration inconsistency excluding those intra-city ones*". Unfortunately, the absence of a widely accepted duration limit, after which an individual who abandoned the native *hukou* is included in the floating population, gives space to large fluctuations in the esteems concerning the dimension of the phenomenon, see Goodkind and West (2002) to have a more exhaustive description of the issue. Drawing on data extracted from the Chinese Statistical yearbook (2015), the number of rural migrants has more than doubled since the beginning of the new century. Floating population represented the 9,5 percent of the total population in 2000 and already almost doubled in 2014 when it accounted for the 18,5 percent, which is to say around 253 million people (figure 2). These data are even more impressive if we consider that, according to the 1990 census, only 21,3 million people had been away from their place of permanent household registration for at least a year on 1 July 1990 (Yu, 2000).

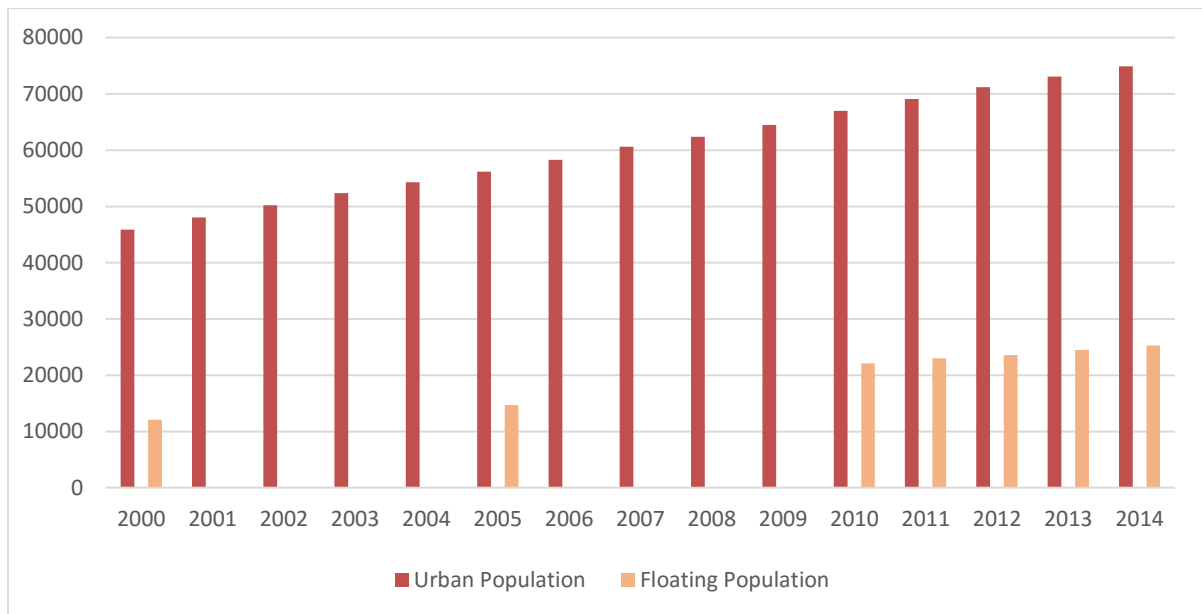


Figure 2. Urban Population and Floating Population (10.000 persons)

Data Source: Chinese Statistical Yearbook (2015)

Although China's mobility rate is still modest if compared to that of advanced industrial economies, the size of the migrant flows and their dramatic economic and social consequences have already profoundly affected economic growth and urban development (Fan, 2008). The consequence of the great economic dynamism and buoyancy following the reform era, was a dramatic upsurge in the floating population, which rapidly reached the 80-100 million compared to a few million in the late 70s, constituting one of the biggest mass migrations of all time (Chan and Zhang, 1999). It is a widely recognized matter of fact that the supply of abundant cheap labour from the rural areas to the industrial sector has long been a key source of China's fast economic growth. There are various pieces of evidence showing that, in export-oriented cities such as Shenzhen and Dongguan, migrant labour accounted for the great majority – up to 70 to 80 percent - of the labour force at the turn of the new century (Liang, 1999; Chan 2007). Although constituting the backbone of the Chinese industrial sector, millions of rural migrants suffered and still suffer from an alarming lack of primary services and poor guarantee of basic human rights. Despite the fact that, as time passes, the *hukou's* regulation on internal migration became evidently unsustainable, primarily from a social point of view, the system is still in place, even if the control was slightly relaxed during the 2000s. The persistence of such an outdated system is partially due to the opposition of Urban citizens who refuse to share their welfare privileges with migrant workers. At the same time, this ostracism is strongly supported by the government who fears the tremendous financial stress that would be necessary in order

to provide adequate welfare to an increasingly congested urban environment (Armstrong, 2013).

1.3 Hukou system and the widening rural-urban gap

China registered a continuous increase in the share of Urban population over the past 30 years and by the middle of 2012, the number of people living in urban areas had surpassed the number living in rural areas (Figure 3. The extraordinary urbanization process, which interested tens of millions of people, was rewarded by many scholars as an unquestionable proof of the admirable improvement in the life quality of the Chinese population.

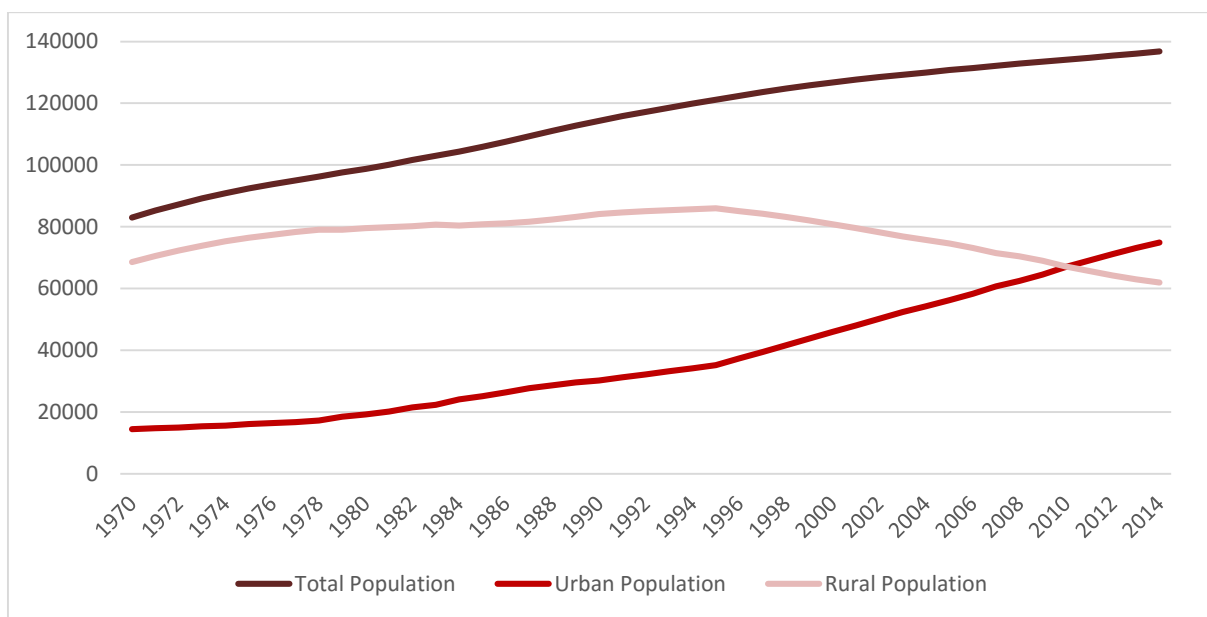


Figure 3. Composition of Chinese Population by residence (10,000 persons).

Data Source: Chinese Statistical Yearbook (2015)

Nevertheless, at the light of what stated in the previous paragraph, this is a superficial conclusion which does not take into account the peculiarity of the Chinese society. In fact, the *hukou* is the real standard by which to measure the peasants' actual status, benefits and progress of urbanization (Cheng, 1991). Besides the provision of cheap labour force to the state's enterprises and the migration control, the *hukou* ensured the maintenance of the welfare privileges granted to the urban residents, by denying the access to basic services to a very large share of the population. Even though the emergence of a certain economic disparity between agricultural and industrial sector is somehow typical of developing countries, the *hukou* had the peculiarity of generating a profound social dualism by defining two distinct Castes: the privileged city dwellers with fully access to state's welfare and job opportunities and the rural

population totally excluded from state-aid. During the pre-reform era, the strict state regulation was able to maintain social order by keeping these two world almost completely apart. In fact, the *hukou* was supposed to ensure food and welfare to the urban population keeping millions of rural workers out of it. However, as the economic reforms gained pace, what the cities really needed was cheap labour force. Therefore, the epochal changes in the economic model, which caused a dramatic upsurge in the migration flows, put the system under great pressure. The new situation forced the Government to embark on a reformation process of the *hukou*, which led to the introduction of a variety of new categories - such as the temporary residents and the so-called blue stamp *hukou* - but did not bring to a substantial elimination of the social segregation and disparity afflicting Chinese rural population. Actually, the disgraceful social disparity affecting Chinese society was even enhanced, as the access to many of the new-created categories was subject to not only strict requirements and quota controls, but also to the payment of special fees, thus definitively excluding the poorest strata of the population. For instance, in the case of the “Blue stamp *hukou*” – a sort of locally valid urban residence permit - the applicants were required to pay a large lump-sum fee, whose incredibly high amount – up to 50.000 yuan in some cities- pushed some people to define it as a real sale of the *Hukou*. Nevertheless, what really has to be born in mind about the social mobility, which followed the reform-period, is that this process led to a social stratification *within* the cities. If the pre-reform period was characterised by the net separation of the two worlds, now the coexistence of the various *hukou* categories within the same city brought under the spotlight the blatant social segregation and discrimination enshrined in Chinese society. What makes this disparity even more unacceptable is that the *hukou* status is hereditary, this means that the children of rural migrants are too often excluded from education, health and other basic services in the cities where they live, even if they were born there. This is also why many children are left behind in the villages, where they are raised by their grandparents, having only sporadic contacts with their parents. It comes without saying that all these elements are at the basis of a rising dissatisfaction, which contributed to the outbreak of social disorders and social unrest in the first years of the new millennium. The general discontent was one of the key factors leading to the emergence of a widespread labour unrest, a phenomenon that greatly affected the wage level and that will be analysed into detail in section 3.

2. China's rising average wages

2.1 Average wage growth between 1978 and 2014

Chinese wages remained stagnant at an utterly low level for many years in the context of the state regulated economy. During the pre-reform era, the economic model was extremely static, with wages and job recruitment set by central government and no space for any form of competition, both in the goods and in the labour market. Even after the reform era inaugurated in 1978 and the instauration of a market oriented economy in 1992, wages struggled to adjust to new conditions, remaining mostly unaffected. Low labour costs together with undervalued currency granted a solid competitive advantage to China and boosted its economic boom, transforming the country into the “Workshop of the World”. In fact, all over the 90s China could count on an extremely cheaper and more abundant labour force than any western economy. Moreover, Chinese manufacturing wages were also consistently lower than the ones of other Asian developing countries, such as the Philippines, Indonesia and Taiwan in the 90s. To be more precise, Chinese manufacturing wage was only about 17 percent of the Philippines' one in 1994 (Li et Al, 2012). However, what really assured a solid advantage to China was the fact that for many years wages grew at an utterly slower pace than labour productivity, making Chinese labour cheap also in real terms. In fact, as far as international competitiveness is concerned, real wage level is not the only factor affecting a country's performance. From this point of view, it might be helpful to have a look at the average growth of Gross Labour Productivity along with the evolution of real wages. Clearly if the GLP is growing at faster pace than real wages, labour costs are low not only in nominal but also in real terms. The simplest way of calculating the Gross labour productivity is by dividing the total output – for example the real GDP- by the total number of workers, in order to obtain the value added per worker. Obviously, this is not a precise measure as it does not keep into account the variation over time and space of other factors, such as human and material capital, however it provides a first rough idea of the evolution followed by the analysed variable. A study of Ceglowski and Golub (2007) offers a very clear evidence of the fact that Chinese relative unit labour cost *vis-à-vis* the USA fell from 38 percent in 1980 to almost to 27 percent in 2002. This suggest that, in the analysed spell, Chinese labour was becoming even cheaper in comparison with the USA one, as the limited real wage growth was lagging behind the fast productivity upsurge. The same study

also provides a very interesting cross-country comparison between China and a group of selected industrialised and developing economies (Table 1).

Table 1. Chinese Productivity, Wages and RULC vis-à-vis Selected Countries, 2002*

	Relative Productivity	Relative Wage	Relative Unit Labour Cost
United States	7.7	2.1	27.0
Japan	8.7	2.6	30.3
EU Average	10.7	2.8	25.8
India	152.1	61.8	40.6
Indonesia	102.4	72.6	70.9
Malaysia (2001)	41.4	16.9	40.8
Korea (2001)	11.6	5.3	45.5
Singapore (2001)	16.6	3.9	23.3
Mexico (2000)	28.1	9.8	34.9
Brazil	22.7	19.9	87.8

* As a per cent of comparator country levels

Source: Ceglowsky and Golub (2007)

Although being limited only to 2002 and to the sole manufacturing sector, this esteem offers a preliminary evidence that, at the beginning of the new century, China was still enjoying a solid competitive advantage in terms of low labour costs in comparison with both the industrialised economies and other developing countries alike. However, after years of almost complete apathy, the average real wage finally started increasing at a very fast pace, performing a record upsurge of 337.8% in the spell between 2000 and 2014 (Figure 4).

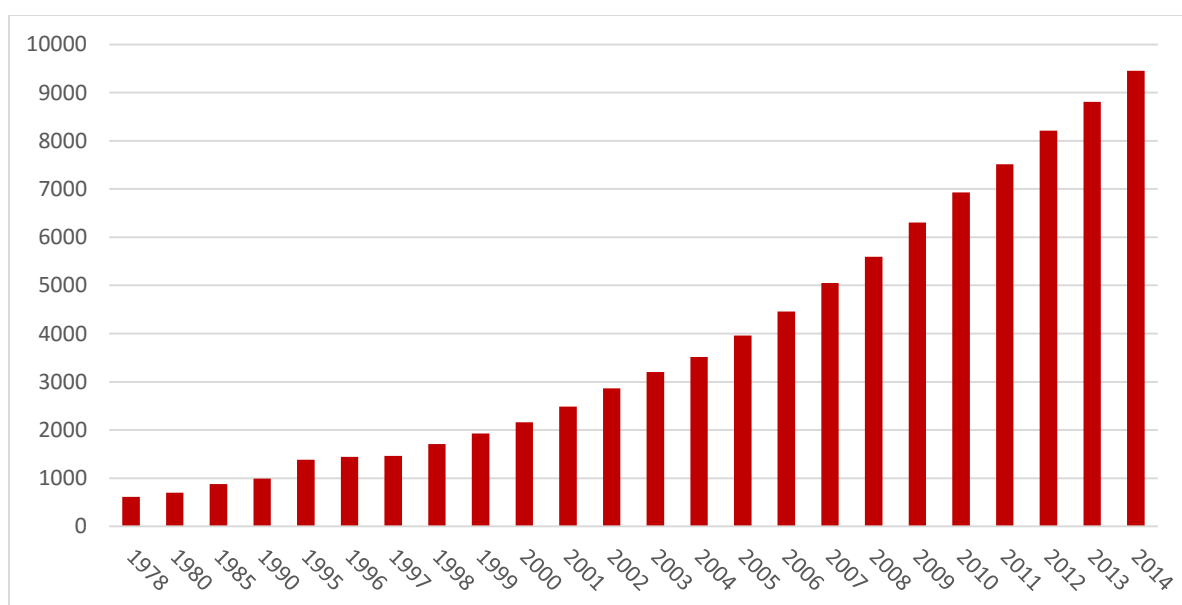


Figure 4. Real Monthly Average Wage of Staff and Workers employed in Urban Units (Yuan

Source: re-elaboration of data from Chinese statistical yearbook (2015) – deflated by CPI (1978=100)

During the years between 1995– the first year from which the National bureau of statistics of China provides continuous data- and 2014, Chinese real wages grew at an average annual rate of 10,69 percent, outpacing the Gross Labour Productivity rate of 9,96 percent. This simple calculation suggests that Chinese labour is undoubtedly becoming more expensive also in real terms. However, the mere observation of the trend followed by the average wage is not sufficient in order to investigate the real condition of many millions of workers. In fact, being an aggregate measure, it is shown to contain different bias terms (Blundell et al, 2003). This is particularly true for a country like China, which is undergoing many deep transformations and is characterised by an array of profound differences between different strata of population, for example between migrant workers and city dwellers or, more in general, between coastal industrialised provinces and inland underdeveloped rural zones. That is why next paragraphs convey a closer examination of the evolution followed by the average wage in different strata of industry, sectors and enterprises’ state of registration.

2.2 Average wage growth by strata of industry, sector and enterprises’ state of registration

Unfortunately, the analysis of the evolution of average wages for different groups of workers is hindered by the scarce availability of data on wages, value added and employment in different sectors. The Chinese Statistical Yearbooks, only provide these data starting from 2003 and exclusively for employed persons in Urban Units, therefore excluding a consistent share of the labour force. However, it is interesting to have a look at the available data in order to understand which sectors were the most affected by the general increase of labour costs.

What emerges from a simple calculation on data published by the Chinese statistical yearbook (2015), is that wages increased almost uniformly in the three strata of industry, with an average annual increase of 10,46 percent for the Primary Industry, 10,48 percent for the Secondary and 9,76 percent for the Tertiary (Figure 5). Nevertheless, if we shift the focus to the single sectors, uniformity gives way to greater fluctuations, especially within the tertiary industry, where the average annual growth in the observed period floats from 12,89 percent for “Financial Intermediation” to 8,11 percent for “Real Estate”. “Financial Intermediation” had one of the highest average real wage already in 2003 – it was outperformed only by “Information, Transmission, Software and Information” – therefore, it is emblematic to notice that it also registered the highest average annual growth not only within the Tertiary Industry but in comparison with all the analysed sectors. In fact, the average real wage in this sector was

17.846,22 *yuan* in 2014, which is to say the highest level in absolute, abundantly above both the general average of 9.289,599 *yuan* and the Tertiary Industry average of 10.433,59 *yuan*. In 2003 the gap between the real wage of “Financial Intermediation”, the overall average real wage and the tertiary industry’s average real wage was definitely smaller, in fact they amounted respectively to: 4.737, 3.184 and 3.751 *yuan*. Obviously, the mere comparison of average real wages and their annual growth is a superficial analysis, but it is nonetheless revealing of the phenomenal boom affecting this sector. Moreover, it provides a valuable suggestion for a future study on this very interesting matter.

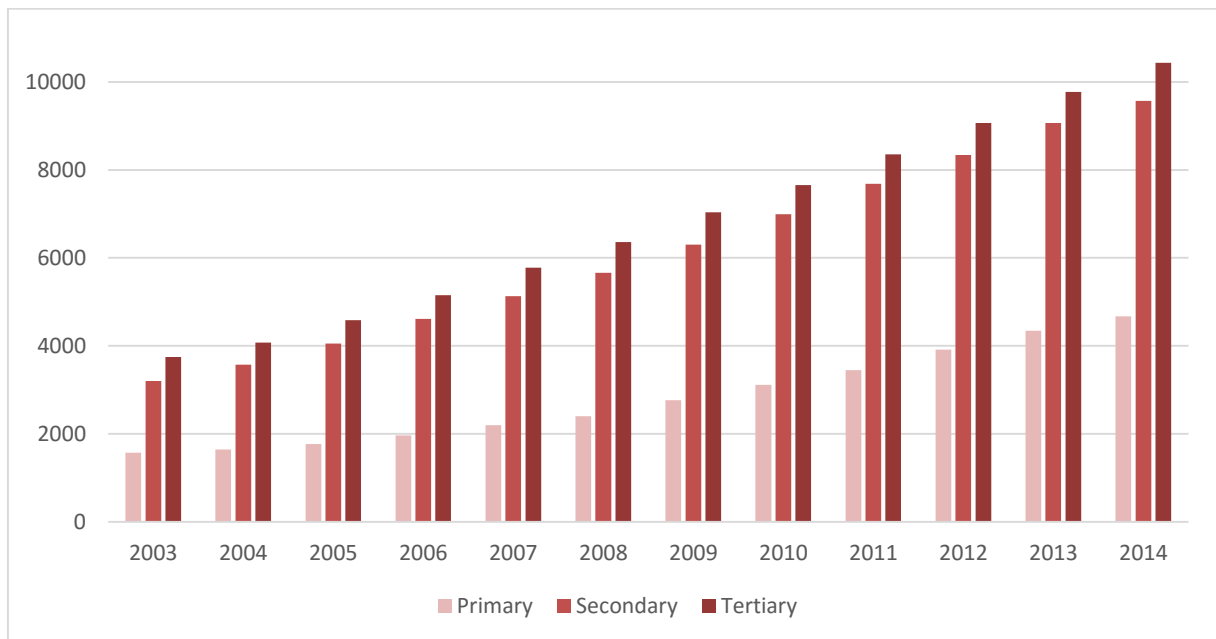


Figure 5. Average Real Wage in Urban Units by three Strata of Industry (Yuan).

Source: Re-elaboration of data from Chinese Statistical Yearbook (2015) – deflated by CPI (1978=100)

Focusing on the Secondary industry, the four sectors detected by the Chinese National Bureau of Statistics, can be easily divided into two groups according to their performance. As showed by Figure 4, “Mining” and “Production and Supply of Electricity, Heat, Gas and Water” were the driving sectors, which acted as a motor of the noteworthy average wage growth of 10,48 percent registered by the secondary industry, while “Construction” and “Manufacturing” lagged behind, laying constantly under the overall average. In particular, “Mining” performed an average wage annual growth of 11,5 percent, while the other three sectors remained in the range between 10,03 and 10,3 percent.

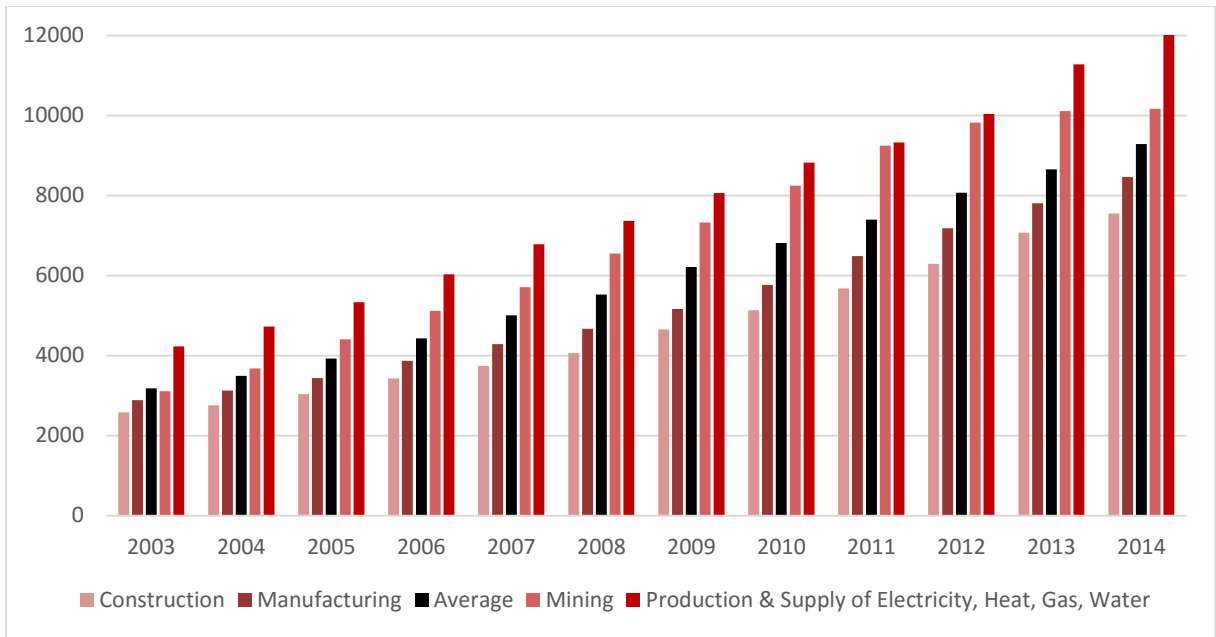


Figure 6. Real wage in Secondary Industry's sectors vs average real wage – Yuan

Source: re-elaboration of data from Chinese Statistical Yearbook (2015) – deflated by CPI (1978= 100)

As far as international competitiveness is concerned, it is interesting to focus on the evolution of the relation between real wages and gross labour productivity for the secondary industry, in particular for the manufacturing sector, which is a heavily export-oriented sector. This choice is also justified by the fact that the manufacturing sector employs a large share of the secondary industry labour force (Figure 7).

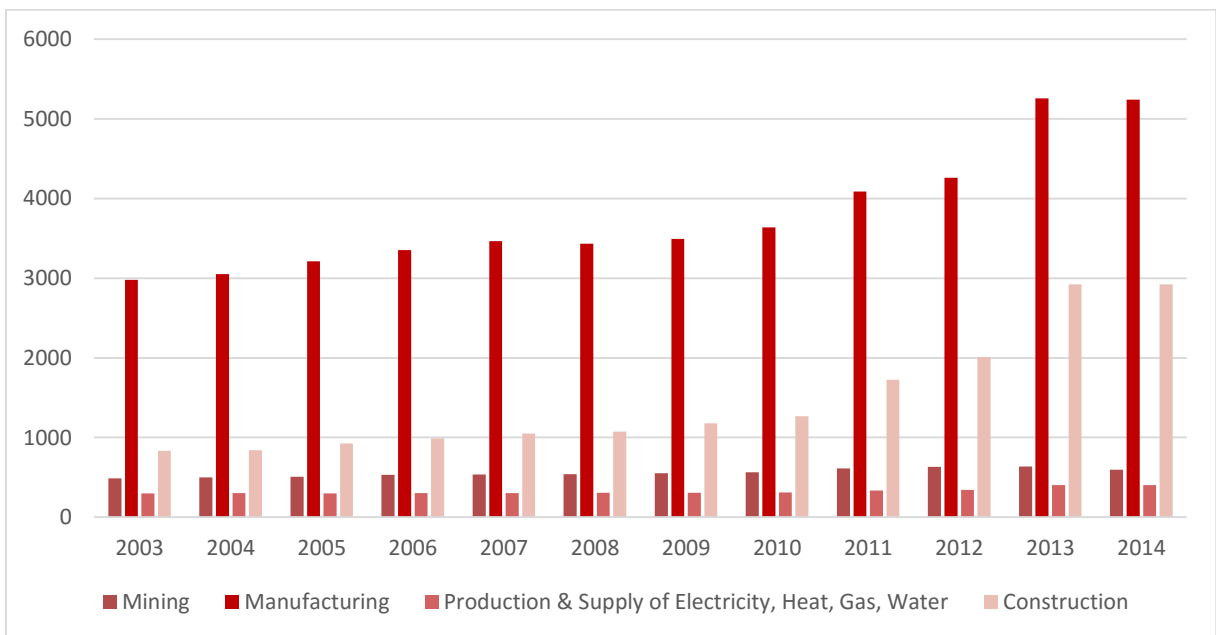


Figure 7. Employed persons in Secondary industry by Sector (10.000 Persons)

Data Source: Chinese statistical Yearbook (2015)

Between 2003 and 2014, “Manufacturing” GLP growth of 71,1 percent was abundantly outmatched by the real wage increase of 193,1 percent, while “Construction” GLP growth was only 23,4 percent, fairly lower than the real wage upsurge of 192,4 percent. This increase in the real cost of labour interested a large share of the labour force, considering that in 2014 around 81,6 million people were employed in these two sectors, which is to say more than one third of the Secondary Industry’s workforce. While observing these data, it is absolutely necessary to remember that the analysed spell comprehend the very difficult years between 2008 and 2011, when Chinese Secondary Industry was heavily affected by the drop in demand caused by the world recession. Obviously the crisis had a severe negative impact on Gross Labour Productivity, wages and employment levels alike.

The detrimental combination of soaring labour costs and *yuan* appreciation put at risk China’s competitive advantage. Nevertheless, in order to assess to what extent these factors affected China’s international competitiveness, it is necessary to observe how productivity and wages varied in other countries. Ceglowski and Golub (2011), provide a series of estimates which allow a comparison between Chinese wages, productivity and labour costs against a range of other developed and emerging economies. Contrarily to what emerged in their former study (2007), in 2009 Chinese manufacturing productivity was lagging behind not only the more industrialised economies but also other middle-income developing economies such as Korea, Taiwan, Singapore and Chile. However, wage differentials were still large enough to grant China with lower relative unit labour costs. The advantage was even wider against European countries, due to the large appreciation of the euro vis-à-vis the yuan in those years. The most interesting finding is that Chinese unit labour costs resulted to be already higher than those of the new low-wage manufacturing exporters in Asia such as Vietnam, Cambodia and Bangladesh, particularly in labour-intensive sectors like apparel. Li et Al (2012) provide an even more detailed analysis of Chinese manufacturing sector. Their approach relies on industry-level data and unit labour costs are investigated by observing the average wage as a proportion of the value added per worker. To do so, they chose a series of two-digit industries, both labour-intensive and capital intensive, and compare their data for 2007 and 2010, drawing some simple but nonetheless revealing conclusions on how their competitiveness was differently affected by the wage increase. What emerges is that, as could be expected, labour intensive industries are major exporters, because they can exploit low labour costs in order to have an advantage on foreign competitors. However, they suffered from a consistent increase of these costs during the observed spell, while capital intensive industries experienced a decline in unit labour costs in the same period. This is an ulterior proof that labour intensive exporting industries are losing

their cheap labour advantage on competitors while capital intensive ones can still benefit from it. Clearly, these general conclusions represent a precious starting point, yet they need to be further investigated.

After the partial liberalisation of Chinese economy, the number and the importance of various economic agents, other than State-Owned enterprises, grew enormously. This new panorama, composed by Share Holding Corporations, Limited Liability Corporations and so on, substituted the former economic model, which was characterised by the absolute predominance of State Owned companies. This process is evident if we consider that the share of employed people in State owned units against the total number of employed people in urban areas, dropped from 59,1 percent in 1995 to 16,1 percent in 2014. Therefore, it might be interesting to have a look at the wage evolution in the different types of enterprise. Before doing so, it is necessary to highlight two things. First, the classification followed is the one adopted by the Chinese National Bureau of Statistics in the publication of the Statistical Yearbook (2015), which is also the source of the analysed data. Second, due to the lack of data concerning the value added by each group, unfortunately it is not possible to observe the evolution of their Gross labour Productivity in this study.

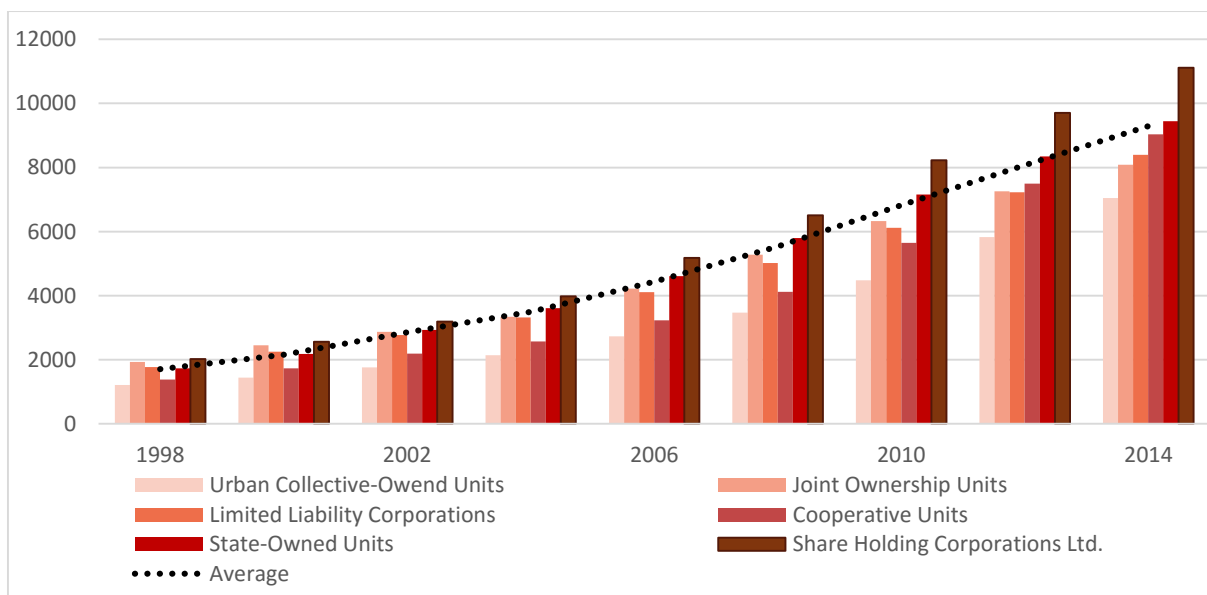


Figure 8. Real wages of employed persons in Urban Units by State of Registration (Yuan)

Source: re-elaboration of data from Chinese statistical Yearbook (2015)–Deflated by CPI (1978=100)

In the spell 1998-2014, the average annual growth of real wages in the analysed groups floated in the range between 9,1 percent for “Cooperative Units” and 11,3 percent for “Share Holding Corporations Ltd.”. However, what is really interesting to notice, is that the wage gap between

the different groups noticeably increased (Figure 8). In particular, the gap between real wages earned by employed people in “Share Holding Corporations Ltd.” and in “Urban Collective-Owned Units” registered an increase of 778,6 % between 1998 and 2014. Obviously, this gap is also partially explained by the opposite trend followed by employment in the two different enterprises, due to the overall revolution of the Chinese Economy. In fact, while “Urban Collective-Owned Units” share of employed people with regard to the total number of Urban employed, collapsed from 16,5 percent in 1998 to 1,4 percent in 2014, “Share Holding Corporations Ltd.” enjoyed an increase from 1,7 percent to 4,45 percent in the same period.

2.3 The negligible growth of rural migrants’ average wage

Unfortunately, the positive trend discussed and analysed in the preceding paragraphs, does not refer to the entire Chinese workforce. First, in 2014 the 49,1 percent of the workforce was employed in rural areas, meaning that 370,4 million people are excluded from the considerations made in the precedent section, as those data only referred to employed persons in urban units. Second, many millions of migrant workers, albeit constituting a considerable part of the labour force, especially in the manufacturing and in the construction sector, are scarcely represented in the official statistics, therefore keeping track of their condition is an utterly difficult task. Drawing on data recently released by the National Bureau of Statistics of China, the number of rural migrant workers in 2015 totaled 277,47 million -1,3 percent more than 2014- and their average monthly income was only 3.072 yuan. An utterly low level, considering that the national per capita disposable income of residents was 21.966 yuan - 31.195 yuan if we only focus on urban households.

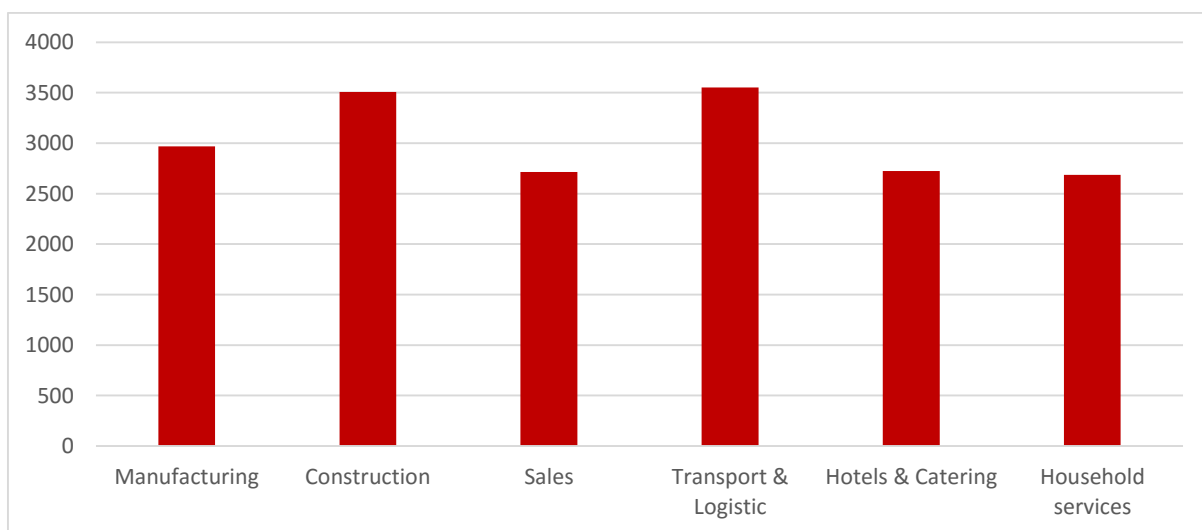


Figure 9. Average Monthly wage for Migrant Workers 2015 (Yuan)

Data Source: China Labor Bulletin (2016)

According to data released by National Bureau of Statistics, also migrants were somehow interested by a wage increase in the last years. In fact, their average monthly wage grew by 9,8 percent in 2013 and by 7,2 percent in 2014. However, besides being slower than the overall average, this wage growth brought them a very limited benefit in real terms. In fact, contrarily to city dwellers, who have large access to state welfare, rural migrants and their families are often charged with high fees in order to benefit from basic services, such as health and education, in the cities where they live. The absence of social insurance for migrant workers is a crucial and long-lasting problem in Chinese society, which risks to explode due to the fast ageing of Chinese population - which will be better discussed in section three. Besides the many detrimental consequences deriving from the lack of a social insurance, there is the fact that many elderly low-skilled workers are forced to look for employment even after the retirement age in order to survive. However, due to widespread age discrimination, they can only get irregular and low paid jobs. Moreover, they are exposed to greater risk of labour abuses as, being over the statutory retirement age, they are not necessarily protected by the Labour Contract Law (China Labor Bulletin, 2015).

As far as labour conditions are concerned, there is a wide literature covering the issue of widespread labour abuses in China. Chinese workers, especially the rural migrants, face a long series of injustices such as underpayment, wage arrears, lack of health and safety protection and exhausting workingtimes (Chan, 2001). According to data released by China Labor Bulletin (2016), in 2015 only 36 percent of migrant workers had signed a formal employment contract with their employer, as required by law. As a consequence, the majority of these workers lack any kind of protection, both in terms of insurance against work-related injuries and of legal protection against employers' abuses. Following the 2015 migrant worker survey conducted by the above mentioned organization, the percentage of migrant workers who experienced wage arrears last year stood at exactly one percent or 2,77 million workers. The construction industry, which employs a large share of migrant workers (Figure 10) was the worst offender, with two percent of the workforce not being paid, up from 1,4 percent in 2014. What emerges from a survey on the construction sector in the Shanghai area, conducted by the Centre for Development Policy and Research of the University of London (2014), is a panorama of widespread labour exploitation and poor working conditions. Besides being subjected to exhausting working rhythms, about 36 percent of the respondents have experienced wage arrears at least once during their employment, while 78 percent have not signed labour contracts with their employers, while among the ones who signed a contract, a third did not even have a copy.

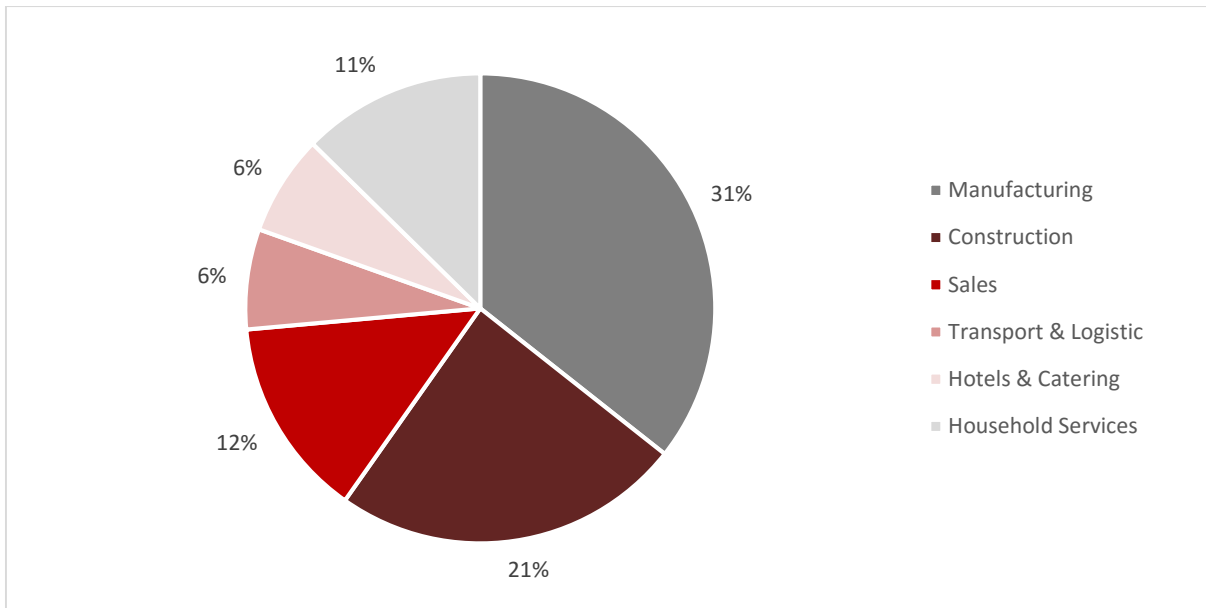


Figure 10. Employment of Migrant Workers by sector 2015

Data Source: China Labor Bulletin (2016)

However, it is emblematic to notice that, when asked to point out the major labour problem, the 41 percent of construction workers indicated the lack of social insurance and labour contract, followed by the absence of special payment for overwork, late payments and the exclusion from Union Representation.

3. Main factors driving the increase of labour costs

Since its partial liberalisation in 1978, China's labour market evolution followed and still follows a highly unusual path. Detecting the factors responsible for the recent wage increase might be very complicated, also due to the fact that China is in the middle of two incomplete transitions: from a rural to an urban industrialised society and from bureaucratic socialism to market economy. Clearly, there are a myriad of different agents acting on wage levels and these factors tend to vary over the course of the years, therefore in this essay no attempt is made to be exhaustive.

3.1 Institutional Reforms

Prior to the reform-era, Chinese economy was a centrally planned economy based on state-owned enterprises and characterised by planned labour allocation and very low wages set by the government. This economic conformation excluded any form of properly named labour market, thus making labour extremely cheap not only in nominal but also in real terms, by denying any form of adjustment of wages to the increasing productivity. Therefore, Chinese

wages remained stagnant for many years, despite a considerable economic growth. The turning point occurred in the mid-to-late 1990s, with an intense process of privatization of a number of state-owned enterprises and a partial liberalisation of trade and prices. As could be expected, such an epochal change involved both positive and negative aspects. On the one hand, with the dismantling of most State-Owned enterprises, tens of millions of workers – mostly illiterate and unskilled- had to look for a new occupation in the booming private sector. Private sector was prone to welcome the so-called *Xiagang* workers, which literally means “laid-off” workers, as their salary expectations were normally lower than the average. Therefore, the massive layoff in the public sector provided the private enterprises with an additional huge reserve of low-cost labour, allowing them to offer very low wages (Gong, 2002). Nevertheless, in the medium to long-term, the continued growth of non-state sector, where wages and labour allocation were unregulated, fostered the emergence of a real labour market. The instauration of a relatively free labour market, involved an array of positive aspects, such as more efficient allocation of labour and the creation of a link between wages and productivity, both within non-state firm and, through competition, within state-owned firms (Cai et Al, 2008). The instauration of an interplay between wages and productivity is also witnessed by the increasing return to education in China. According to an esteem based on data of an Urban Household Survey in nine provinces, the return to college education versus high school increased from 7 percent in 1988 to 49 percent in 2009 (Li et al, 2012). While Zhang and colleagues (2005) report that the average rate of return to education for urban workers increased from 4 percent in 1988 to about 10 percent in 2001.

Another institutional key factor explaining the wage growth was the increase in minimum wages. Since the adoption of a new minimum wage regulation in 2004, the frequency and magnitude of changes in minimum wages have been considerable. According to data released by the Ministry of Human Resources and Social Security, minimum wages increased at an annual average of 13 percent in the last five years (Scott and Scott, 2016). The large differences in the minimum wage level, not only between coastal and inland regions, but even within the same provinces and prefectures, is due to the strong regional character of Chinese economy. The country’s economic structure has long been characterized by multilevel planning, with local governments controlling nearly half of total industrial output and allocating substantial resources, thus *de facto* exerting a substantial control over enterprises. Consequently, institutional reforms have not brought a direct and uniform transfer of decision-making authority from the central government to the single agents (Wong, 1987). This peculiar structure, together with obvious geographical differences, concurred in the definition of a highly

imbalanced economic development between coastal and inland provinces and also partially explains the large wage gap between different provinces. In fact, minimum wage level across China in 2015 ranged from more than 2.030 yuan per month in the major financial centres like Shenzhen down to 1.100 yuan per month in the poorer, more remote provinces, such as Heilongjian (China Daily, 2015). Minimum wages grew at an undeniably fast pace in the last years, however the picture is not as positive as it might look like. First, minimum wage in China has never been a living wage, and employees earning it usually have to rely on excessive overtime and production bonuses just to get by (China Labor Bulletin, 2015). Second, as it was predictable, the increase of minimum wages had an adverse impact on the employment levels. Evidence shows that minimum wage increase in the period 2000-2007, had a significant negative impact on employment, especially on low wage firms (Huang et al, 2014). Moreover, Fang and Lin (2015) present evidence that the minimum wage upsurge had a severe adverse impact on employment in the eastern and central regions of China in the spell 2000-2009, and resulted in disemployment for the more disadvantaged strata of the labour force, basically females, young adults, and low-skilled workers.

3.2 Demographic Changes

According to the United Nations (2015), Chinese total population amounts currently to 1,38 billion people and it is likely to total 1,4 billion people by 2022. Afterwards China's population is expected to remain constant until the 2030 and then to start slightly decreasing, while India's population is projected to continue growing up to 1,7 billion in 2050. In fact, restrictive family planning policies introduced in 1979 concurred together with other factors in fostering the transition of China from a high to low birth-rates country, (Figure 11). Chinese women fertility rate of 1.56, far below the rate necessary for keeping a population steady, is now between the world's lowest. Therefore, China's population is ageing at the very fast pace, as it is revealed for example, by the fact that in the last decade the number of under 14 dropped by more than a third, while the number of over grew by more than 60% (Worldbank, 2016). The described demographic transition, involving far more people preparing to leave the labour market than entering it, constitute a severe threat to Chinese economic growth and development goals if not addressed properly. According to the National Bureau of Statistic esteems China's labour-force already peaked in 2011. This worrying trend was probably behind the recent Government decision to lax the one-child policy, allowing Chinese couples to have up to two children.

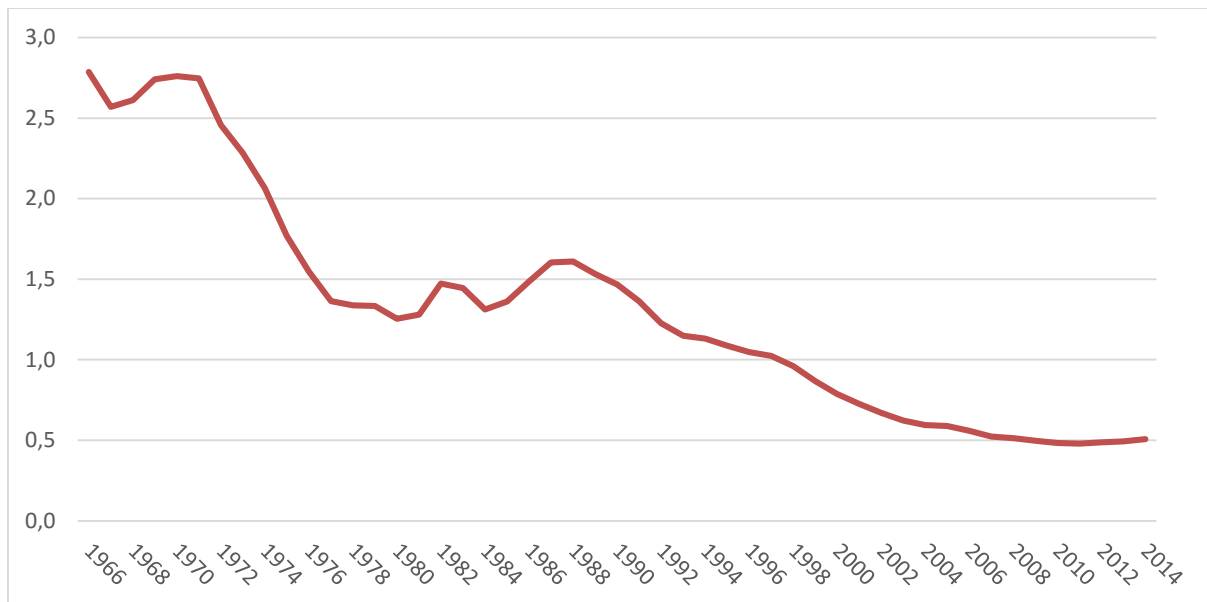


Figure 11. Chinese Population Annual Percentage Growth

Data Source: Worldbank Database (2016)

However, the counter-reform is likely to have just a minor impact and will not slow consistently the ageing process of the labour-force (OECD, 2015). There are many forces affecting population growth, between them the fact that very low fertility can become self-reinforcing, with children of one-child families wanting only one child themselves, therefore China will probably face a long period of ultra-low fertility (Parker, 2012).

The large pool of rural workers provided Chinese industrial sector with a cheap and flexible labour force during the booming years. However, rural-to-urban migration flows are shrinking as well. In the last years, the number of migrant workers increased constantly, yet the rate of growth has dropped noticeably over the last five years from 5,5 percent in 2010 to just 1,3 percent in 2015 (China Labor Bulletin, 2016). The major obstacles to ulterior migration flows are a combination of institutional restrictions, such as the *hukou* regulation, and the fact that the marginal cost of migration is rising (Li et al, 2012). In fact, the proportion of young rural residents working outside agriculture may have already peaked. In 2007 more than 81 percent of the individuals aged between 16 to 20 years and more than 80 percent of the cohort between 20 to 30 years composing the rural labour force, were already working in the off farm sector (Rozelle and Huang, 2008). These data suggest that the supply of young cohorts of workers is getting exhausted, therefore the costs of migration are rising as the marginal migrant is becoming older.

The overall contraction of China's working-age population together with the slowing of migration flows are obviously two of the main factors driving the fast wage growth. According

to press reports (Huang, 2004; Curran, 2015), China is already experiencing labour shortages, especially in the heavily industrialised coastal cities. The position/seeker ratio grew steadily in the last years moving from 0,65 in the first quarter of 2001, to 1,1 at the beginning of 2014, meaning that the number of job vacancies exceeded the number of job seekers (MHRSS, 2014). As a consequence, a debate has opened on whether China has passed the Lewis turning point. A developing economy reaches the Lewis point when the labour pool offered by the underdeveloped agricultural sector is basically exhausted, causing labour shortages and urban wages to rise dramatically (Lewis, 1954). According to some scholars China will reach this stage somewhere between 2020 and 2025 (Das and N'Diaye, 2013), while other studies argue that the turning point already occurred in 2003 (Zhang et al, 2011).

3.3 Labour Unrest

In the last years China has experienced rising social and labour unrest, resulting in protests, demonstrations, picketing and strikes, as a consequence of the deep discontentment of large strata of the population. In particular migrant workers and their families who, despite being the living engine of China's economic growth, keep living in a condition of inhumane exploitation, social exclusion and poverty. In fact, expectations among workers are growing, together with consciousness about their rights. This is particularly true for the younger workers, who being raised under the influence of China's rapid economic growth, are less prone to accept overloaded jobs and adverse working conditions as their fathers and mothers did and are increasingly frustrated with the treatment they receive (HU, 2012). Obtaining better working and paying conditions through the institutional channels, such as the bargaining table, is particularly difficult in China, due to the fact that only one workers' organisation is recognised by the law, the "All China Federation of Trade Unions" (ACFTU). Therefore, workers are not free to form or join trade unions of their choice, because any other trade union organization, whether local, national or industrial, is submitted to the ACFTU. This is one of the reasons why China belongs to the ten worst countries in the world for working people, with a score of five, the worst achievable, in the ITUC Global rights Index (ITUC, 2016). A score of five means absolute absence of rights guarantees with systematic repetition of abuses against workers, such as arrests, lack of due process, precarious work and discrimination. However, also thanks to the role played by social media, worker resistance increased consistently in the last decade and strikes became one of the main factors driving the raise of industrial wages. The turning point for the country's labour movement occurred in 2010, when the suicide of some Foxconn workers and the large strike at the Nanhai Honda car plant, drew for the first time immense

social attention, both locally and globally (Sio-ieng Hui et al, 2011). Until now, the measures adopted by the Government to deal with the soaring labour unrest, such as the employee contract law and the collective bargaining legislation, have been insufficient and the State risks to remain stuck in an “Insurgency trap”. In fact, China is not the first country facing the consequences of a massive industrialization process, yet, by only allowing for one state-controlled labour union, the Government failed in re-directing workers’ discontentment into legal and rationalised modes of contention (Friedman, 2014).

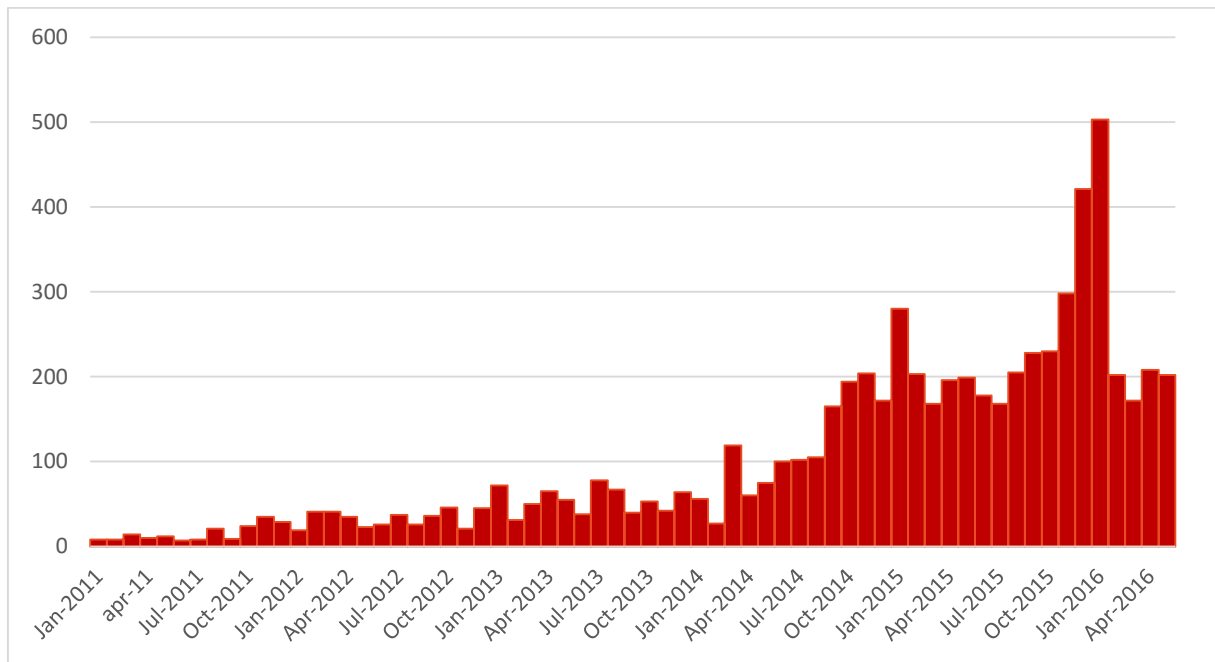


Figure 12. Number of Strikes per month from January 2011 to May 2016

Data Source: China Labor Bulletin – Strike Map (2016)

The absence of an institutional channel of dialogue, involves the frequent outbreak of workers’ discontentment into strikes and violent protests. Drawing on data released by China Labor Bulletin, the number of strikes exploded in the last few years, raising from 186 strikes in the 2011, to 2.763 in the 2015 and 1.293 in the first half of the 2016 (Figure 12). Unsurprisingly, around the 63 percent of all strikes occurred in the analysed spell, showed “Wage Arrears” between the leading causes. Moreover, as could be expected, the strikes were concentrated in the heavily industrialised coastal provinces, while more than one third of all the protests occurred in the Manufacturing and another 28,2 percent in the Construction sector (Figure 13).

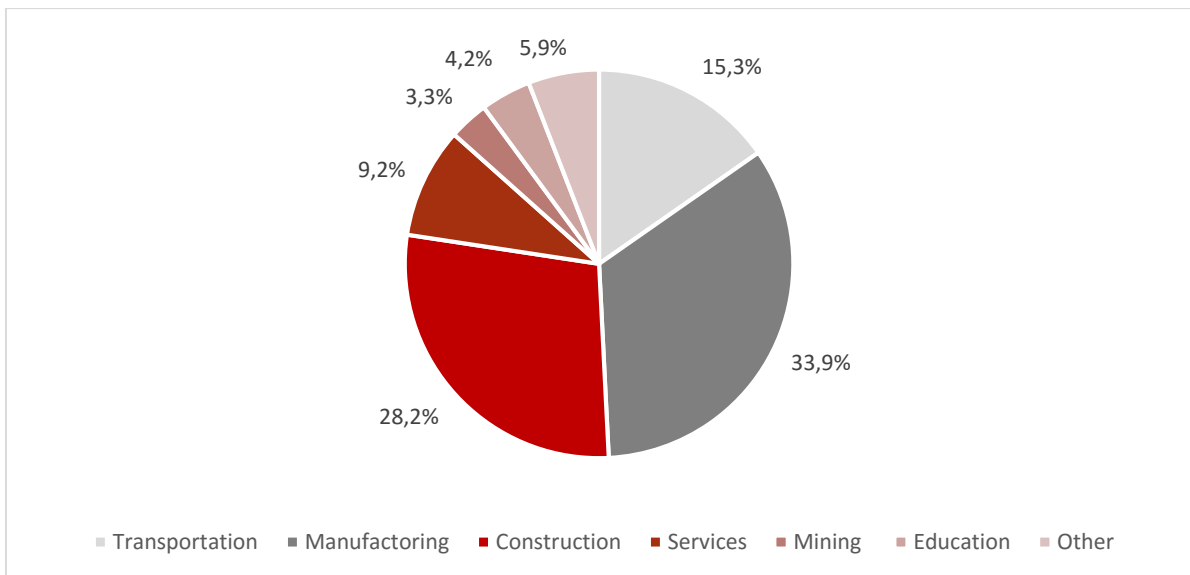


Figure 13. Strikes in China by sector between January 2011 and May 2016

Data Source: China Labor Bulletin – Strike Map (2016)

It is unsurprising that when the global financial crisis hindered production in factories across China making the threat of massive lay-offs real, large segments of the labour force rebelled. However, the cause behind the widespread labour unrest, might be not only an economic reason but a social one as well. In fact, according to the Hong-Kong based workers' rights group, China Labor Bulletin, the recent economic downturn of Chinese economy, and the consequent increase in the layoffs, only partially explains the increase in the number of strikes. The major triggering cause is again the widespread abuse of the workers' rights, for which both the employers and the Government are to be blamed. In fact, China has labour laws that are supposed to protect workers' rights, but they are systematically violated (Cooney, 2007).

4. Wealth inequality and the future scenario for Chinese economy

4.1 Income inequality as a threat for Chinese long-term economic growth

In a very short spell, China has transformed from poor agricultural economy to one of the world's greatest economic powers, enjoying astonishing two-digit GDP growth rate for many years. According to the World Bank Classification, China joined the upper-middle income group in 2011, with a per capita income of \$5.445. Unfortunately, this important achievement is at odds with the condition of many millions of workers, especially rural workers and migrants, who keep living and in very poor conditions and have been excluded by the benefits of economic development, despite being at the base of China's extraordinary growth. Chinese

society is characterised by profound inequality. Fully access to state’s welfare and better job opportunities is granted to the privileged urban dwellers, while the rural population and the migrant workers are in large part excluded from any state-aid and forced to endure an utterly heavy discrimination. During the industrialisation process, the gap between the richest and the poorest strata of population widened constantly (Figure 14). Most of the inequality increase occurred in the top half of the wage distribution, with wage growth of the rich and highly educated growing particularly rapidly (Park et al, 2008). Moreover, there are pieces of evidence, focused on the growth incidence curve – which is the extent to which each quintile of households benefits from growth in real terms - showing that China’s widening income inequality is mostly due to income growth among the rich, rather than stagnant living standards among the poor (Cevik and Correa-Caro, 2015).

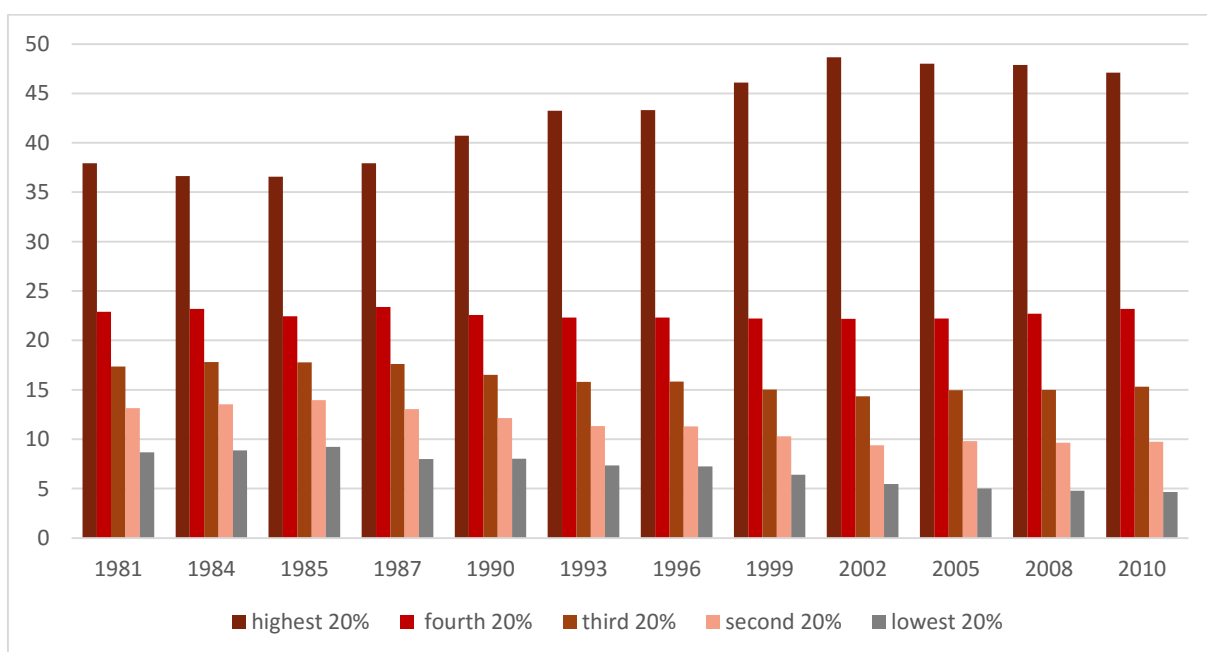


Figure 14. Income distribution by Population Quintiles

Data Source: Worldbank Database (2016)

In fact, since the reform era, per capita income has increased, the share of people living under the poverty line of 1,90\$ a day (in 2011 PPP) has dropped from 88,3 percent in 1981 to 11,2 percent in 2010 and about 800 million people were lifted out of extreme poverty (Worldbank, 2016). However, not enough has been done for the poorest strata of population, who keep living in a substantial lack of services and civil protection offered from the state, while public and private enterprises benefit from their cheap labour (Armstrong, 2013).

Besides the many moral questions stemming from it, there are pieces of evidence showing that income inequality hinders economic growth over the long term. A study from Berg and Ostry

(2011), tries to assess the impact of different factors on the economic growth duration. One of their most striking findings is that a decrease in inequality is a most robust predictor of longer growth spell, than other factors usually associated with long growth duration. Clearly, significant policy adjustments are required in order to make long term growth sustainable, otherwise China risks to get caught in the “Middle Income Trap”, which is to say a condition where a country is not able to move ahead to the high income group, remaining stuck in the middle income category. Many researchers indicate inequality as one of the main reasons for the MIT. The fact that China did not follow the East Asian model of development – characterised by the combination of high growth with equitable income distribution - letting inequality rise to a dramatic level, heavily contributed to China’s macroeconomic imbalance, declining efficiency of capital and rising social unrest (Islam, 2015).

It is undeniable that the continuing dramatic increase of income inequality has become a peculiar characteristic of Chinese development. To some extent, an increase in the income gap is a normal consequence in the first stages of development, as theorized by Simon Kuznet (1955). According to his theory, income inequality initially rises with economic development but after reaching its maximum it drops in advanced stages of economic development. Therefore, the relationship between the income inequality and the average income - for instance GDP or GNI per capita - has shape of an inverted U-curve. Income inequality in China, as measured by the Gini coefficient (a measure of inequality ranging from zero, which represents perfect equality, to one, perfect inequality), increased from about 0,3 in the early 1980s to more than 0,45 in the early 2000s. After reaching the level of 0,49 in 2008, it has slightly declined but remained well above 0,45 (Sicular, 2013). With a Gini index approaching 0,5 China is now among the most unequal countries in the world. As could be expected, urban-rural income gap was one of the major factors driving income inequality in recent years. In fact, its contribution to overall inequality was 45 percent in 2002, and 51 percent in 2007 (Li et al. 2013).

Obviously, there are many other elements concurring in the emergence of a widening income inequality between the richest and the poorest strata of population in China. Gupta and colleagues (2008) found that a worsening in the corruption index of a country by one standard deviation involves the same increase in the Gini Index as a reduction in secondary schooling of 2,3 years. Their result is based on a cross-country analysis for 1980-97 and holds for countries at different stage of development and with different growth experience. Besides the *Hukou* discrimination and high corruption levels, many scholars think that rising returns to education account for great part of the widening gap. As discussed in section three, earnings differentials between different categories of urban workers expanded rapidly since the late 1980s. Meng and

colleagues (2010) found that between 1988 and 2007 the variance of log earnings of urban workers raised from 0,27 to 0,48, increase by 78 percent. At the same time, there are pieces of evidence showing that the average rate of returns to education for urban workers increased from 4 percent in 1988 to about 10 percent in 2001 (Zhang et Al, 2005), while returns to formal schooling for migrants remained stable at approximately 3 percent and 5 percent between 1995 and 2008 (Cui et Al, 2013). Moreover, Knight and Song (2003) provide evidence that increased dispersion of returns to education seems to account for a significant part of the extended income inequality in China.

4.2 China's Transition toward a more sustainable model of development

Labour market pressures are evident in recent labour unrest and reports of labour shortages. These pressures, along with the large increase in minimum wages, the fast demographic transition and the yuan appreciation, resulted in rising labour costs, eroding China's competitive advantage based on abundant and cheap labour. During its economic boom China enjoyed large flows of foreign investments and multinationals, attracted both by Chinese low labour costs and huge booming internal market. However, for many foreign companies, things are getting harder, due to the detrimental combination of slowing growth and soaring costs. According to a recent survey conducted by the American Chamber of Commerce in China, 25 percent of respondents have either moved or are planning to move production outside of China, mostly in other countries of "Developing Asia", such as Vietnam, Malaysia and the Philippines. Rising labour costs represent the most common complaint (AmCham China, 2016). Moreover, various press reports state that the number of companies moving to Vietnam from China is likely accelerate, mostly due to China's higher labour costs, this trend is highlighted by the large flows of foreign investments already being re-directed in Vietnam (Lee and Folkmanis, 2013; Timms, 2015). However, despite the soaring labour costs, China still holds an advantage on the above-mentioned countries, mostly in terms of better infrastructures and more efficient supply chain. Moreover, Chinese firms are also relying on increasing shares of automation in order to raise productivity, in the attempt of partially offset the effect of rising wages (The Economist, 2012). Nevertheless, the fact that low-cost and labour-intensive production is gradually leaving China, although involving a series of severe shocks on the labour market on the short-term, does not necessarily involve the end of Chinese economic growth. During the boom, China has relied on an unsustainable growth model, based on extreme labour exploitation and large flows of foreign direct investments, now the country is facing the transition to a slower but more sustainable growth (IMF, 2015). Rising wages and education levels are fostering Chinese enterprises

progressive move up on the value chain, shifting from low-cost manufacture to higher value-added production. This is for example the case of companies like Xiaomi and Huawei, whose growth is also likely to be enhanced by the increasing internal demand. Migrant workers might represent once again one of the main drivers of economic growth. Since 2013, the share of services in value added has outmatched that of manufacturing and it will rise further, boosting economy-wide growth, if urbanization proceeds and public services are extended to the millions of rural workers living in Chinese urban areas (OECD, 2015). The transition from a manufacture-based economy towards a service-based one, is also heavily fostered by the fact that Chinese population is rapidly ageing. This process represents both a problem for Chinese current economic model, still largely based on the exploitation of cheap labour, and a severe financial challenge for the Government. However, in the medium to long term, it will also create a growing market healthcare and services. Through massive investments in education and R&D, China is already gradually moving toward a new model of development and in a few decades might join a place alongside South Korea and Japan as a leader in high value-added manufacturing and innovation (Li et Al, 2012). However, the achievement of this ambitious goal requires an array of drastic structural reforms in order to smooth the transition for tens of millions of workers and create suitable incentives for the emergence of new sustainable sources of growth, avoiding the collapse under the huge pressure exerted by large income inequality and the fast demographic transition.

Conclusions

Cheap labour was at the base of China's economic miracle, boosting the economy for almost twenty years. In fact, China could attract large flows of FDI and foreign multinationals by offering an extremely abundant and cheap labour force. However, after years of almost complete apathy, real wages finally started increasing at a very fast pace, performing a record upsurge of 337,8 percent in the spell between 2000 and 2014. This extraordinary positive trend was caused by the interplay of various factors. First, an array of institutional reforms, such as the instauration of a market oriented economy, which also involved the creation of a real labour market and the creation of a link between wages and productivity. Second, the very fast transition of China from a high to low birth-rates country, which resulted into a worrying process of ageing and declining of the workforce. Third, the mounting labour unrest which resulted in the exponential increase in the number of strikes and violent protests. The main factors triggering the outbreak of violent rebellions are largely related to the systematic abuse of workers' rights in China. In particular, many millions of migrant workers, albeit constituting

a considerable part of the labour force, especially in the manufacturing and in the construction sector, were excluded from the benefits stemming from economic development. It is a matter of fact that Chinese society is afflicted by profound wealth and social inequality, in particular between the privileged city dwellers and the poor workers coming from the rural provinces. The rural-urban gap is exacerbated by the *Hukou* regulation, the outdated and discriminatory Chinese household registration system. Besides the many moral questions stemming from widening inequality, there are pieces of evidence showing that it also represents a serious threat to economic growth over the long term. Therefore, China needs to address this pressing social issue with adequate measures in order to avoid remaining stuck in the Middle Income Trap. Moreover, the combination of labour shortages, raising wages, labour unrest and yuan appreciation is eroding the Chinese competitive advantage in terms of low labour costs. As a consequence, many companies are already moving their productions in other countries of the Developing Asia, where they can find a new large pool of cheap workforce. Nevertheless, the fact that low-cost manufacture is leaving the country does not necessarily sign the end of Chinese growth. In fact, sociological studies already demonstrated that, after a phase of massive industrial development, modern societies are prone to evolve towards a more knowledge-based economic model, which is founded on human capital rather than on manual labour. Through huge investments in education and R&D, China is already gradually moving toward a new model of economic growth. However, the inauguration of a new era of more sustainable development is subjected to the adoption of the necessary structural reforms in order to deal with China's pressing social, economic and demographic issues.

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