Senate Democratic Policy Committee Hearing

"Do China's Abusive Labor Practices Encourage Outsourcing and Drive Down American Wages?"

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The key contention of the AFL-CIO Section 301 Petition, that China's growing exports to the US market are based on "China's persistent denial of workers' rights [which] gives China-based producers an unfair cost advantage" (Petition p. 65), is not well founded.

The basis for this contention is the petition's estimate that if China were to end its persistent repression of workers' rights that the average wage would rise by between 90 and 595 percent (Petition, p. 81). This estimate is seriously flawed. It is based on a series of assumptions, which may seem to be superficially plausible, but are poorly supported. More importantly the petition's estimated increase in wages, which flows from these assumptions, is not plausible for the simple reason that labor productivity in China is too low to support the postulated wage increase. The estimated wage increase would lead to the bankruptcy of most firms since the resulting wage bill would exceed the entire value-added for the average firm.

The petition's "best estimate" that China's labor repression has displaced up to 727,130 U.S. manufacturing jobs (Petition, p. 97) also is not credible. It is based on the assumption that ending worker repression in China would increase the cost of Chinese manufactures by an average of 43 percent, which in turn is tied to the mid-range estimate that in the absence of labor repression the average wage of workers would rise by about 340 percent. As noted immediately above, this wage estimate is not plausible.

The petition repeatedly asserts that its results are based on very conservative assumptions (see for example Petition, p. 82). In my judgment this is quite misleading because the results that flow from the petition's assumptions are largely devoid of any connection to economic reality.

The petition repeatedly mischaracterizes and sometimes ignores the most basic aspects of China's economy. Some of these points are illuminated by referring to a series of diagrams I have provided under the title "Chinese Wages and Exports."

Wages in Chinese manufacturing

The petition asserts repeatedly that despite rising productivity that wages in Chinese manufacturing are stagnant or even falling. For example it asserts "The wages of China's factory workers have stagnated in the last decade" (Petition, p. 4); "The real earnings of this sub-caste [of factory workers] have remained static or fallen throughout the unprecedented boom in capital investment" (Petition p. 13); " . . . the wages of factory workers have remained flat or fallen in the last decade, even as productivity has risen." (Petition, p. 44).

As shown in diagram 1, real per capita gross domestic product in China last year was 7 times the level of 1978 when economic reform began. Real per capita gross domestic product was more than double the level of a decade ago in 1993. This economic growth has translated into substantial gains in real wages and living standards in China. As shown in the second diagram, the average real after-tax disposable per capita income of urban households last year was more than 5 times the level of 1978 and double the level of a decade ago in 1993. Rural per capita income, shown in the third diagram, while lower also has increased dramatically. Last year in real terms rural per capita income was 5.5 times the level of 1978 and 60 percent greater than a decade ago. Turning to wages, as shown in the fourth diagram, in the state sector the average real wage in 2002 was 3.5 times what it was in 1978 and twice the level of 1992, a decade prior. As shown in the fifth diagram on page 6, since 1993 the average nominal wage in manufacturing establishments run by foreign affiliates, state companies, and collective companies have all increased by significantly. In real terms, wages increased by between 45 and 65 percent, depending on form of ownership. This is the decade over which the petition repeatedly asserts that wages have fallen.

I know of no credible evidence that average real wages in manufacturing in China have stagnated or declined over any multi-year period in the past two and a half decades.

The role of foreign affiliates

From the sixth diagram at page 7 we can see that the average foreign affiliate pays wages that are 30 percent higher than the average in state-owned enterprises and twice the average level of collective firms. On average foreign affiliates also have higher occupational safety and health standards and observe higher environmental standards than Chinese owned firms. Yet from the seventh diagram on page 8 it is clear that foreign affiliates are China’s most dynamic exporting companies. Their share of China's exports rose from 1 percent in 1985 to 55 percent last year. Last year foreign affiliate exports were US$240 billion. The experience of these firms, which pay above average wages and have better health, safety, and environmental standards, certainly casts doubt on the basic idea of the AFL-CIO 301 petition--that China's comparative advantage arises from the denial of workers' rights that, in turn, provides China with an unfair cost advantage. Foreign affiliates pay the highest wages in China and have better health, safety, and environmental standards yet they have enjoyed the greatest success in contributing to China’s export performance.

Chinese Imports

The AFL-CIO petition calls the growth of Chinese exports a "supply shock" for the global economy and provides a wealth of detail on the recent growth of China's global exports (Petition, pp. 60-65). The petition, however, is strangely silent on the subject of China's imports. A reader of the petition might gain the impression that Chinese labor costs are so low that foreign goods could not be competitive in China's market. That impression would be fundamentally mistaken. Over the past decade Chinese imports quadruped from US$104 billion in 1993 to US$413 billion last year. Since China joined the WTO in late 2001 its imports have increased by 70 percent. Last year alone China's imports rose by 40 percent and China surpassed Japan to become the world's third largest importing country. China's global trade surplus last year was only $25 billion. This surplus was only 1.8 percent of China's gross domestic product, one of the lowest ratios in Asia. In the first two months of this year imports rose 42 percent over the same period in 2003 and China incurred a trade deficit of almost $8 billion. China's import growth has been so rapid that it has become a major source of economic growth in Japan, Korea, Taiwan, and countries in Southeast Asia. China is also far and away the fastest growing among the large export markets of United States firms. The petition makes no reference to the creation of jobs in US manufacturing as a result of our growing exports to China.