As China's Wages Rise, Export Prices Could Follow

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SHANGHAI — The cost of doing business in China is going up.

Coastal factories are increasing hourly payments to workers. Local governments are raising minimum wage standards. And if China allows its currency, the renminbi, to appreciate against the United States dollar later this year, as many economists are predicting, the relative cost of manufacturing in China will almost certainly rise.

The salaries of factory workers in China are still low compared to those in the United States and Europe: the hourly wage in southern China is only about 75 cents an hour. But economists say wage increases here will eventually ripple through the global economy, driving up the prices of goods as diverse as T-shirts, sneakers, computer servers and smartphones.

"*For a long time, China has been the anchor of global disinflation*," said Dong Tao, an economist at Credit Suisse, referring to how the two-decade-long shift to manufacturing in China helped many global companies lower costs and prices. "*But this may be the beginning of the end of an era.*"

The shift was illustrated Sunday, when Foxconn Technology, one of the world's largest contract electronics manufacturers and the maker of well-known products that include Apple iPhones and Dell computer parts, said that it was planning to double the salaries of many of its 800,000 workers in China, beginning in October. The new monthly average would be 2,000 renminbi — about $300, at current exchange rates.

The announcement follows a spate of suicides at two Foxconn campuses in southern China and criticism of the company's labor practices.

Foxconn, based in Taiwan and employing more than 800,000 workers in China, said the salary increases were meant to improve the lives of its workers.

Last week the Japanese automaker Honda said it had agreed to give about 1,900 workers at one of its plants in southern China raises of 24 to 32 percent, in hopes of ending a two-week strike, according to people briefed on the agreement. The new monthly average would be about $300, not counting overtime.

And last Thursday, Beijing announced that it would raise the city's minimum monthly wage by 20 percent, to 960 renminbi, or about $140. Many other cities are expected to follow suit.

Analysts say the changes result from the growing clout of workers in China's economy, and are also a response to the soaring food and housing prices that have eroded the spending power of workers from rural provinces. These workers, without factoring in the recent wage increases by some employers, typically earn $200 a month, working six or seven days a week.

But there are other reasons. Analysts say Beijing is supporting wage increases as a way to stimulate domestic consumption and make the country less dependent on low-priced exports. The government hopes the move will force some export-oriented companies to invest in more innovative or higher-value goods.

But Chinese policy makers also favor higher wages because they could help ease a widening income gap between the rich and the poor.

Big manufacturers are moving to raise salaries because they are desperate to attract new workers at a time when many coastal factory cities are struggling with labor shortages.

A Foxconn executive said last week that the turnover rate at its two Shenzhen campuses — which employ over 400,000 people — was about 5 percent a month, meaning that as many as 20,000 workers were leaving every month and needed to be replaced.

Marshall W. Meyer, a China specialist at the Wharton School at the University of Pennsylvania, says that demographic changes in China are reducing the supply of young workers entering the labor force and that this is behind some of the wage pressure.

"*Demography will do what the Strategic and Economic Dialogue hasn't: raise the cost of Chinese goods*," he said, referring to United States-China talks on Chinese currency reform and other economic issues. "*There is no way out.*"

Economists say many of the same forces that were at work in 2007 and 2008, when China's economy was overheating, have returned and even intensified this year.

Local governments have stepped up enforcement of labor and environmental regulations, driving up production costs.

And perhaps most troubling for companies here is the prospect of an appreciating Chinese currency, which would make their exports more expensive overseas.

Beijing has long promised to allow its currency to fluctuate more freely. But when the global financial crisis shuttered many Chinese factories, the government effectively repegged the renminbi to the dollar to protect exporters.

Pietra Rivoli, a professor of international business at Georgetown University and the author of "*The Travels of a T-Shirt in the Global Economy*," says the effects of rising labor costs will vary by industry, perhaps with lower-valued goods like garments being forced to move to western China or even to Vietnam and Bangladesh.

But she says high-end electronics like smartphones are likely to remain, because they command high profit margins and because China has built a sophisticated infrastructure and quality-control system.

"*Labor is such a small piece of the pie for them*," Professor Rivoli says of the electronics brands. "The money's all in the design, the marketing and the complicated distribution system, including retail outlets. Like with Apple, they have those rents in the shopping malls, fancy stores and all those hip people working there. That costs a lot."

Still, salary increases are expected to affect many stages of the supply chain and force some companies to raise prices. For many exporters who simply produce on contract for global brands, profit margins are already razor-thin, and raising prices could hurt business.

"*They're going to have to find a way to pass this on to the end user,*" says Mr. Tao at Credit Suisse.

Economists say a necessary restructuring is under way, one that should allow the nation's huge "floating population" of migrant workers to better share in the benefits of growth and stimulate domestic consumption.

United States and European Union officials have been pressing China to help improve the global economy by consuming more and reducing the country's huge trade surpluses.

Rising labor costs here are not the end of cheap production in China, analysts say, but they are likely to help change the country's manufacturing mix.

"*China isn't going to lose its manufacturing base because it's got a huge domestic market,*" said Mary Gallagher, director of the Center for Chinese Studies at the University of Michigan. "*But it will move them toward higher-end goods. And that matches the Chinese government's ambition. They don't just want to be the workshop of the world. They want to produce high-tech goods.*"

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