

# ***SHARP RISING OF THE LABOUR COSTS IN CHINA***

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## **Report of the 9<sup>th</sup> Round of Labour Inspection in China for**



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## 1. THE INSPECTION

The 9<sup>th</sup> round of unannounced labour inspection was carried out between 14<sup>th</sup> and 16<sup>th</sup> of August 2013.

Table 1-1: The 9<sup>th</sup> round of labour inspection – participating factories <sup>3</sup>

Factory	City/Province/Area class <sup>4</sup>	Inspected before ?
Changshu Huaerda Garments Co., Ltd	Changshu/Jiangsu/I	No
Nanjing Sunshine Outdoor Co., Ltd	Gaochun/Jiangsu/II	No
Dyna group, Shengtang Garments	Huaian/Jiangsu/III	No
Dyna group, Langshi Garments	Huaian/Jiangsu/III	No

The general results from this round of inspection are presented in Chapter 2.

Chapter 3 is dedicated to a topic in focus: the social security schemes and practices

Chapter 4 is dedicated to another topic in focus: Sharp rising of labour costs puts China in dilemma

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<sup>3</sup> Special thanks to Chris and Carrie from the trading companies for their kind assistance for this inspection. Thanks to all the participating factories for their openness, cooperation and kind reception of the inspection.

<sup>4</sup> The area classification is dedicated to the economic conditions in different cities and counties within a province. Jiangsu province is for example divided into 3 categories/classes: class I, class II and class III. Class I indicates the most developed areas where the living standard is highest within the region, while class III indicates the poorest areas. The classification has something to say about, for instance, the minimum wage standard and the social security baseline. (See more about the minimum wage standard and the social security baseline in chapter 2 and 3.)

**2. The general results from this round of inspection**

2.1 General information

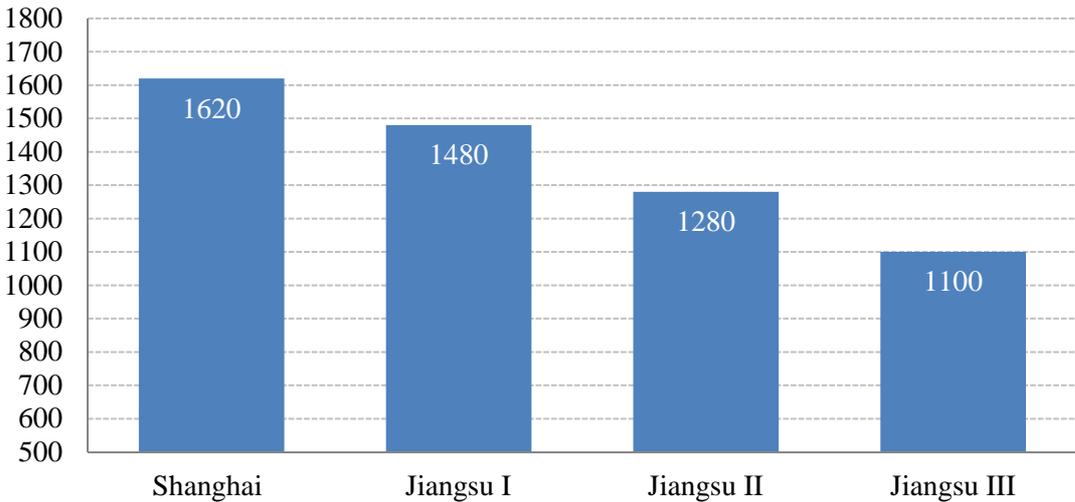
All the inspected factories are located in Jiangsu Province.

Jiangsu province is one of the most developed provinces among the 31 provinces in China. Jiangsu province has 6% of the total Chinese population, occupies only 1% of the total area of China, but creates 10% of the total Chinese economy. In sum, Jiangsu province is a small province in terms of area, but a big one in terms of population and economy.

Jiangsu province has a long tradition in textile industry. Silk products from Jiangsu province are very famous throughout the history. In many counties and towns the textile industry is still a cornerstone industry for these local communities, and many local residents, especially women, are still living on making clothes according to the traditions and heritage. The whole infrastructure and foundation for the textile industry is quite good in Jiangsu province.

All the inspected factories have therefore local skilled workers as the main work force. The problem of recruitment of new workers seems much less severe here than other parts of the coastal regions, because they are less dependent on the migrant workers as the main supply of labour force.

**Minimum wage standard 2013, Yuan/month**



The regional minimum wage standard is often an indicator for the local living costs. As shown by the chart above, the minimum wage standards that apply for these factories are different depending on the classification of the area (see footnote 4) which the factory is located in. High cost areas have the highest

minimum wage standards while low cost areas have the lowest minimum wage standards, even though they are in the same province. The minimum wage standards have something to say about the general wage levels and social security fees, especially for a low-income industry like the textile industry.

## 2.2 Working environment, health and safety

The working environment in all the inspected factories is fairly good. The workshops are equipped with ventilation, air-condition or cooling/warming facilities. In this summer, the weather has been extremely hot for the whole region. Some extraordinary measures for cooling have been taken, for example placing a lot of ice in the workshops and providing workers with plenty of cold drinks.

At the background of a recent spate of accidents, including a big fire and a factory-building collapse in Bangladesh that killed more than 1 100, we put a special attention on safety conditions in all the inspected factories. We are satisfied to find out that in all the inspected factories, the fire fighting devices are properly placed, the emergency exits are clearly marked and kept unblocked and the emergency lights are properly installed. The local fire fighting authorities run as a rule fire emergency drill twice a year at the factories, and all the employees have taken the fire fighting courses

## 2.3 Basic labour rights

Neither child labour nor forced labour was discovered under the inspection. There has been no severe labour conflict reported at these factories. All factories have implemented major requirements from the Chinese Labour Contract Law. Standard written labour contracts are signed between the employers and the employees.

## 2.4 Labour conditions

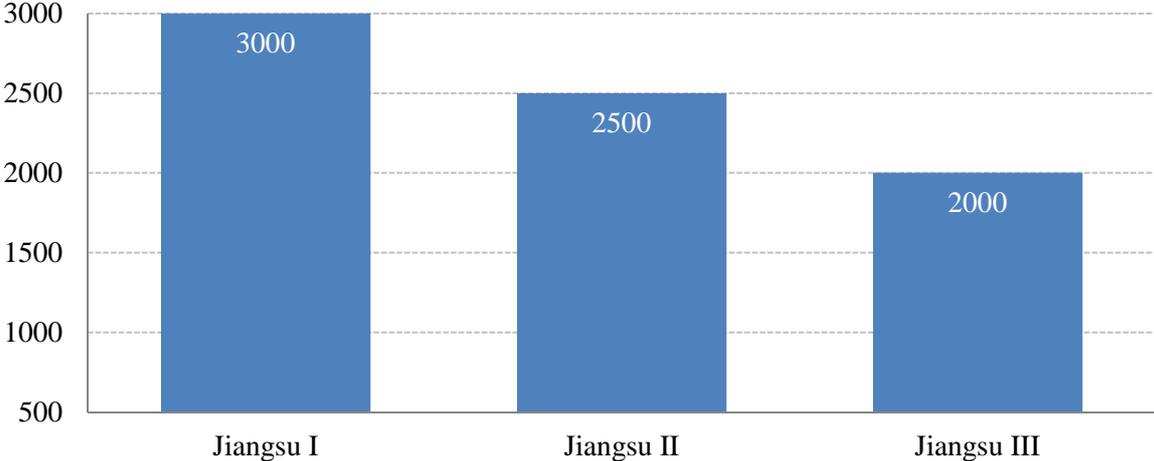
### **Employment**

As mentioned above, the main labour supply in these inspected factories is from the local residents. Thus, there is less dependence on migrant workers, unlike many other coastal areas where many manufacturing factories are facing a severe problem of recruiting adequate working force. The working staff in all the inspected factories is relatively stable. However, all of them still express a clear concern for employment. The turnover rate in these factories is 10 – 20% every year. The factories have to put in more efforts and resources in order to keep the workers in the factories and attract new workers to the factories. The competition on labour becomes harder and harder.

**Wage**

The income level has been raised remarkably among all the inspected factories in the past several years. The average monthly income for an average skilled worker varies from 2000 to 3000 RMB depending in which area the factory is located.

**Average wage level 2013, Garment factories, Yuan/month**



**Working time**

All the inspected factories report less use of overtime. However, it is still common that workers get only 1-2 days free in a month.

The distribution of working time is also quite uneven. There is still extensive use of overtime in the so-called “high seasons”. It happens that in some days the factory has no order in production. The workers are dismissed (“permittert” ) with a minimum compensation. The workers are obligated to resume work at the first time when the factory calls upon them.

**Social security contribution**

See chapter 3.

2.6 Labour relations

All the inspected factories are unionized. However, it varies much whether the union in the factory is well functioning. Two factories claim that their unions have nothing to do at all. Other two factories report that their unions are functioning quite well. The unions work as a channel to facilitate workers’ requests and demands. They participate in determination and calculation of piece wages, and communicate quite well with the management as the representatives for the employees.

### 3. Topic in focus: The social security schemes and practices

The social security schemes in China are still under construction and not yet completed. The whole system is somehow complicated. The Chinese Labour Contract Law identifies clearly employer's legal obligation on social security contribution for employees. The enforcement of this law since 2008 has strengthened the social security practices and endorsed a more clear regulation on the social security schemes.

Normally the social security schemes include the following social insurances, and both employers and employees pay a certain share of wage income as the social security contribution:

#### The current social security schemes in Jiangsu province <sup>5</sup>: the main structure

Social insurance	Employer's contribution	Employee's contribution
1. Basic Pension Insurance	20%	8%
2. Basic Health Insurance	8%	2% + 10yuan (so-called additional insurance for major diseases)
3. Unemployment Insurance	2%	1%
4. Work-related Injury Insurance	1%	
5. Maternity Insurance	1%	
6. Collective Housing Fund	3.5%	3.5%
<b>Sum:</b>	<b>35.5%</b>	<b>14.5% + 10yuan</b>

The social security contribution is calculated as a certain percentage of an employee's monthly salary. If an employee has 3000 yuan as his/her monthly salary, the social security contribution should be:

From the employer:  $3000 \times 35.5\% = 1065$  yuan/month

From the employee:  $3000 \times 14.5\% + 10\text{yuan} = 445$  yuan/month

Then this employee is fully insured in the social security system.

In the social security system, a minimum wage for social insurance (so-called **baseline for social insurance - BFSI**). This minimum wage concept is different

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<sup>5</sup> Please be aware that even within the same province, the share of contribution for employers and employees may have some minor differences across different regions.

from the mandatory minimum wage standard and is calculated as 60% of last year's average wage level for all employees within the province.

The average wage level for all employees in Jiangsu province in 2012 is 4273 yuan/month. Then the baseline for social insurance for 2013 in Jiangsu province is 2564 yuan/month (60% of the average wage level from last year). It means that if an employee has a monthly salary lower than the BFSI, he/she and his/her employer should pay their social security contributions based on the BFSI, not the actual monthly income.

For those employees with high incomes, there is also a maximum wage for social insurance (ceiling) calculated as 6xBFSI (which is 15384 yuan/month in 2013).

Taking into account that the average income levels across different regions within the same province may differ much, those low-cost regions are allowed to apply lower BFSIs:

**Baseline for social insurance (BFSI), 2013, Jiangsu Province:**

Level 1: 2564 yuan/month

Level 2: 2299 yuan/month

Level 3: 2025 yuan/month

Depending on the average income level in the region (city or county) comparing to the average income level in the province.

Bearing in mind that Stormberg's suppliers are small-sized private enterprises in a traditionally low-income industry, they, along with most of the small-sized private manufacturing enterprises, don't fully comply with the legal obligation in their practices. Actually even among these 4 inspected factories, there are quite different practices, and none of them fully comply with the law. There are many reasons that have caused this problem:

- Enforcement failure

In which degree the enterprises comply with the law depends much on how strict the local governments (authorities) enforce the law. Still in some regions, the enterprises are left to their own decisions on whether they want to "buy the social insurances" for their employees or to whom they want to "buy the social insurances".

Some enterprises are stilling using the social security schemes as a reward to those employees who have long service time in the enterprises or who have "settled down" for the enterprises.

- Sector difference

The collective housing fund is a voluntary social arrangement which first and foremost apply for the public sector and state-owned enterprises. Very few enterprises in the private sector include this social arrangement into their social security practices. None of the inspected factories do so either.

- A selective system

The basic pension insurance and the basic health insurance are often considered as “must”. When employers say that they pay for the social security contribution for their employees, they are as usual referring to these two social arrangements. However, these two social arrangements account for nearest 30% of the wage cost for employers. Employer’s contribution increases every year along with the employees’ wage increases

The other 3 social insurances on unemployment, maternity and work-related injury are often left to own decisions from the enterprises. Some enterprises choose away all of these 3 insurances. Some enterprises only “buy” maternity insurances for young women employees. Some enterprises choose work-related injury insurance.

One inspected factory told that the road lights outside the factory are not so good. It is dark and dangerous in the evening when the workers return home. Risk for traffic accident is high. So the factory buys work-related injury insurance for all their employees.

- Low income and BFSI

The wage level in the textile industry is low. In addition, the monthly incomes for workers are not evenly distributed. In some months (high season) the monthly pay can be high due to much overtime and long working hours, and in some months (low season) the monthly pay can be very low. To be convenient, the enterprises use BFSI (minimum standard), not the actual monthly pay, as the basis for social security contribution. For many workers, it doesn’t matter too much since their actual wage level in average is not far from the BFSI-level. For some high-skilled workers, there may be a disadvantage since the benefit level depends on the contribution level. Pay less and get less. They would have got a higher benefit level if the employer paid social insurance contribution according to their actual wage income.

- System defect

In some cases, we hear often that workers selves don’t want these social securities. They are often blamed as “near-sighted”, and have too much focus on “cash today” instead of “security tomorrow”.

To some extent it is the system defect one should blame for. Today, we are still short of a national converting system which allow the workers (especially those migrant workers) to work somewhere and accumulate their social security rights and take out the social security benefits somewhere else (for instance in their hometowns). In some provinces, there is already a converting system in place within the province. As long as we don't have a national converting system, it is hopeless to encourage more participation in the social security schemes from the migrant workers since they may risk losing all their acquired social security rights when moving back home.

**Conclusion:**

We are seeing that more and more enterprises are complying with their legal obligation on social security contribution for the employees. The whole social security system is still under construction and improvement, and the system is quite complicated. The social security practices among the inspected factories differ. There are many reasons explaining why there is no full compliance among the small-sized, private-owned manufacturing enterprises.

#### **4. Topic in focus: The sharp rising of labour cost puts China in dilemma**

The Chinese leaders seem to have made up their mind – in the current phase, the most important job for the Chinese economy is restructuring – from a heavily investment and export driven economy towards a more domestic market oriented one. The economic structure should transformed from a low technologic, low value-added and polluted one towards a high technologic, high value-added and more environment friendly one. The Chinese leaders are even willing to trade lower growth rate for that purpose.

The 14% wage rise for private-sector workers in 2012, reported by China's National Bureau of Statistics, represented an acceleration from 12.3% in 2011. Over the period, China's annual economic growth rate slowed to 7.8% from 9.3%.

Wages in the China's manufacturing sector have risen 71% since 2008, according to the National Bureau of Statistics. Improvements in labor productivity, which the World Bank estimates is growing at about 8.3% a year, offset some but not all of the wage growth.

Enforcement of the Chinese Labour Contract Law since 2008 has imposed much stronger pressure on the labour costs as the employers are forced to pay the social security contributions for their employees.

On the one hand, big increases in wages help the rebalancing of China's economy—a key objective for the new leadership. With growth in wages outstripping the rest of the economy, households' slice of the pie is getting bigger. Strengthening the social security schemes can reduce peoples' need for high sparing. The government hopes that will drive higher levels of consumption, helping wean the economy off its addiction to exports and investment as drivers of growth.

On the other hand, higher labor costs also hurt business profitability and export competitiveness—which could pose its own risks to the economic recovery. Sharp rising of the labour costs could prove difficult to sustain as countries nearby threaten to encroach on China's manufacturing dominance.

Countries such as Bangladesh, Cambodia and Vietnam have all ramped up their garment sectors as global retailers look for alternatives to China.

Crystal Group, an apparel producer for Marks & Spencer, says it has more than tripled its staff in Vietnam over the past three years, but made only small increases in its China workforce.

A recent spate of accidents, including a factory-building collapse in Bangladesh that killed more than 1100, has focused new attention on whether a shift away from China will be a wise choice.

Some experts say worries that China is pricing itself out of its manufacturing edge may be overblown. Supply-chain linkages, strong infrastructure and access to China's own market make the case for keeping a foothold. Overall, most manufacturers operating in China are still profitable even though their margins are being squeezed. The underlying strategic rationale for manufacturing in China is still very powerful.

Meanwhile, there must be a breakeven point or a melting point when the Chinese manufacturing no longer can bear the labour cost increases. The manufacturing sector is forced to have a uplifting and update in order to continue to be competitive. However, the process can be painful and imposes challenges for employment which is also a key focus for China's leaders.

All the inspected factories confirmed this picture. They have all experienced a sharp rising of the labour costs during the last several years. At the moment, the factories are still able to bear the burden, and the breakeven point hasn't come yet. But the future outlook is not very optimal and is worth worrying.

So far we have been lucky, and we haven't seen unemployment rates going up, with real estate, infrastructure, and services supporting strong job creation. In the longer run, wage growth can't be sustained without profit growth. If the corporate sector remains weak, rapid wage growth will be difficult to sustain.