Cheap Labour and Competitiveness

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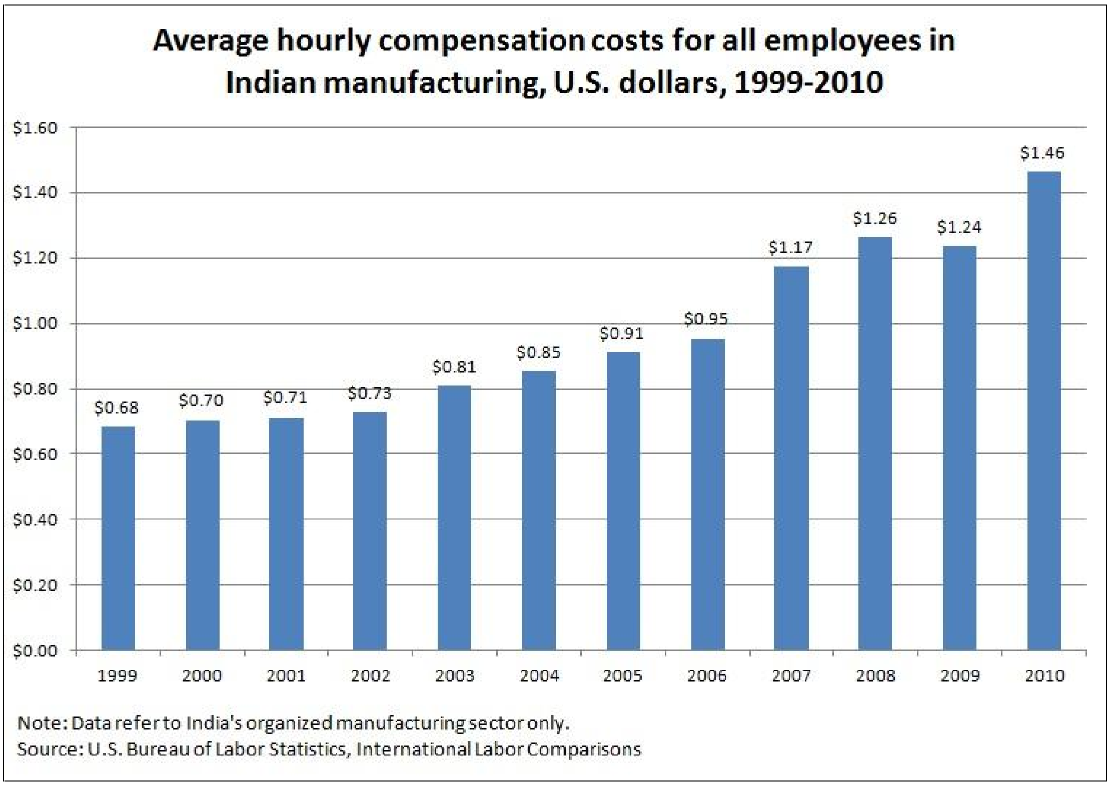


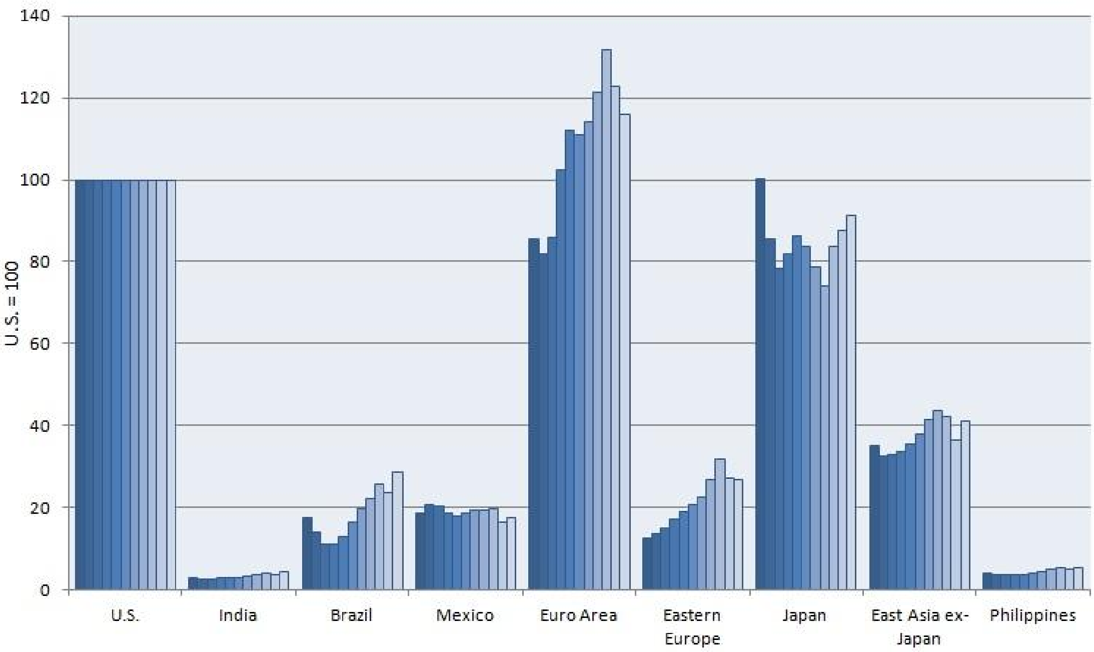
For years now China has been the world's manufacturing powerhouse, leveraging its cheap labour and much else to dominate global trade in general and developing country exports in particular. But, of late, talk that China has reached the Lewis turning point, when it runs out of access to a cheap labour reserve at a near constant real wage has gained currency. This, it is argued, could undermine its competitiveness in a range of products, making way for new suppliers exploiting the benefit of a cheap labour force. According to a Deutsche Bank study quoted by the Financial Times: "Since China's WTO accession in 2001, real wages paid in the manufacturing sector have risen by almost 200% in USD-terms, surpassing Thailand and closing the gap with the Philippines. Strikingly, Chinese wages continued to move ahead in 2009-11, even as regional peers felt the dampening impact of the global recession."

Is this China story true? And if so would India be among the countries that benefit? International comparisons of unit labour costs are difficult to come by, but some numbers are available from a few sources. This discussion is based on estimates made by the Bureau of Labour Statistics (BLS) of the US government. Despite the difficulty involved in generating comparable numbers the BLS has (till recently) routinely put out figures on unit labour costs in different countries as part of its International Labour Comparison programme. China and India were not part of the regular programme, but the BLS conducted special studies of labour compensation in these countries, being careful to underscore the dangers of comparing data that are different in terms of method, coverage and reliability across countries.

A special BLS study on India found that labour compensation (including pay for time worked, directly-paid benefits (excluding payment in kind), social insurance expenditures, and labour-related taxes) in India's organised manufacturing sector had risen over the last decade from 0.68 (Rs.29.43) an hour in 1999 to $1.46 (or Rs.66.84) in 2010 (Chart 1). The rise among production workers (as opposed to all employees) has been lower from $0.53 (Rs.22.68) to $0.92 (Rs.41.87) per hour.

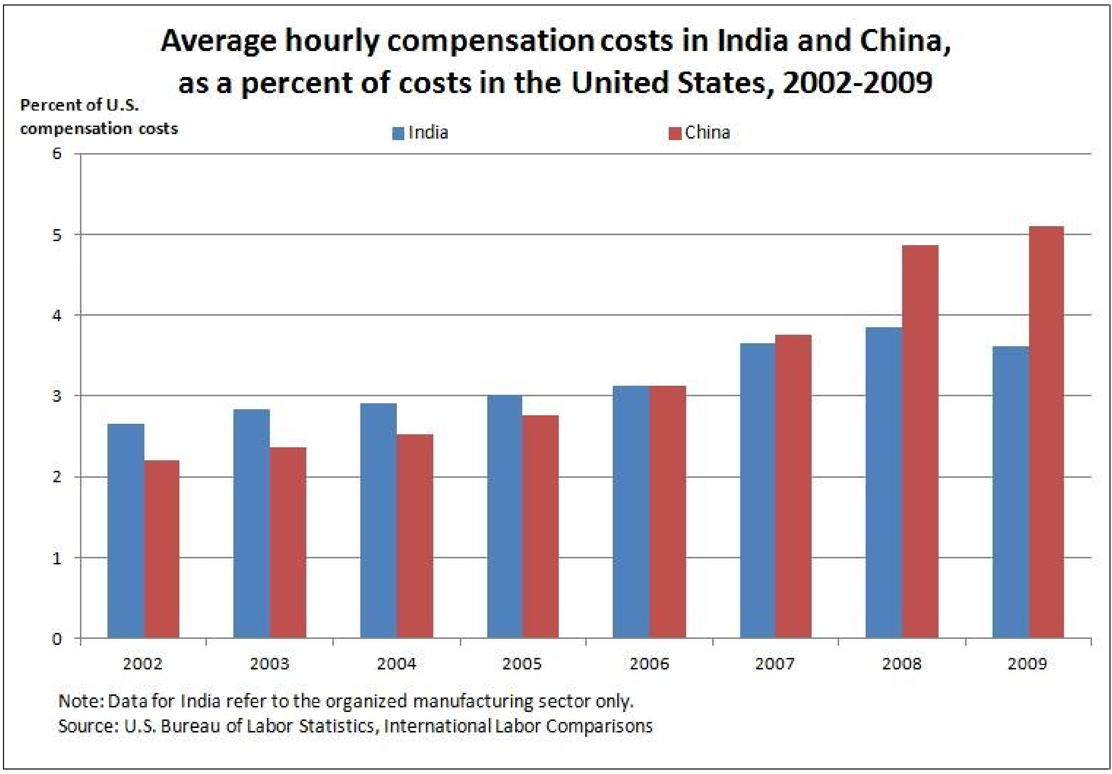
However, what matters from the point of view of competitiveness is not just compensation but unit labour costs in a common currency, which depends on compensation, productivity and the exchange rate. During this period, improved access to technology post-liberalisation had resulted in a sharp increase in productivity in many industries, reflected in a rise in value added per worker in the Indian organised manufacturing sector. This was also the time when the rupee was depreciating, excepting for 2007-08 when a capital inflow surge resulted in an appreciation of the currency. So all told India's competitive position was improving considerably. This comes through in the comparison of average hourly labour compensation costs in India and elsewhere (Chart 2), which shows that India compares favourably with most competing countries excepting the Philippines.

Average hourly compensation costs for all employees in manufacturing, selected economies and regions, 2000-2010



Note: Data for India refer to the organized manufacturing sector only.
For a description of the economic groups, see the technical notes at www.bls.gov/ilc/ichcctn.pdf, Table 2.
Source: U.S. Bureau of Labor Statistics, International Labor Comparisons

How was China, which is the country all aspiring developing country exporters are seeking to at least partially displace, faring in this period? As Chart 3 shows, measured as a percentage of US compensation costs, while China was recording a lower level of compensation costs when compared with India (though the two were close to each other), matters had changed significantly by 2009 with Chinese compensation costs racing ahead.



There are several aspects of the Chinese experience that need to be taken note of. To start with, there has been a sharp increase in the average hourly compensation costs of manufacturing employees in China (in US dollar terms) after 2005. The figure had doubled over 2005 to 2009. This meant that though compensation costs in China were much lower than in many other locations, they did increase the competitiveness of countries like India.

All that said, however, the evidence is as yet disappointing. India's share of the world's exports of goods and services measured in current US dollars on a balance of payments basis stood at 1.2 per cent in 2005 and 2 per cent in 2012 according to World Bank statistics. That performance is better than that of Brazil's, whose export share rose from 1.0 to 1.3, but way short of China's, whose share rose from 6 to 9.7 per cent. Given the evidence on labour compensation costs, conventionally seen as an important determinant of competitiveness, this differential in performance calls for an explanation. Possibly, a host of other factors such infrastructural constraints and the willing of business to target competitive global markets make for the difference.

(This article was originally published in The Hindu on February 6, 2014)