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CSIC White Paper

The facts about

Production Costs in

China



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Summary

Written by James Cissel, Staff Writer/ Researcher at the Shenzhen-based China Sourcing Information Center (CSIC), this whitepaper is designed to address the topic of what international buyers need to know about the costs of labor in China.

Target Audience

Buyers sourcing or interested in sourcing from China. Foreign manufacturers in China.

About the Publisher

Founded in 2010, the China Sourcing Information Center (CSIC) is a not-for-profit organization that exists to educate, develop, and advance the China sourcing profession. Support from corporate sponsors and donations from individuals help keep the following services available to the public free of charge:

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Table of Contents

Summary

What international buyers need to know about the costs of labor in China

Doom and gloom for China Sourcing? Hardly

Price vs. Cost

Tap the domestic market

Conclusion

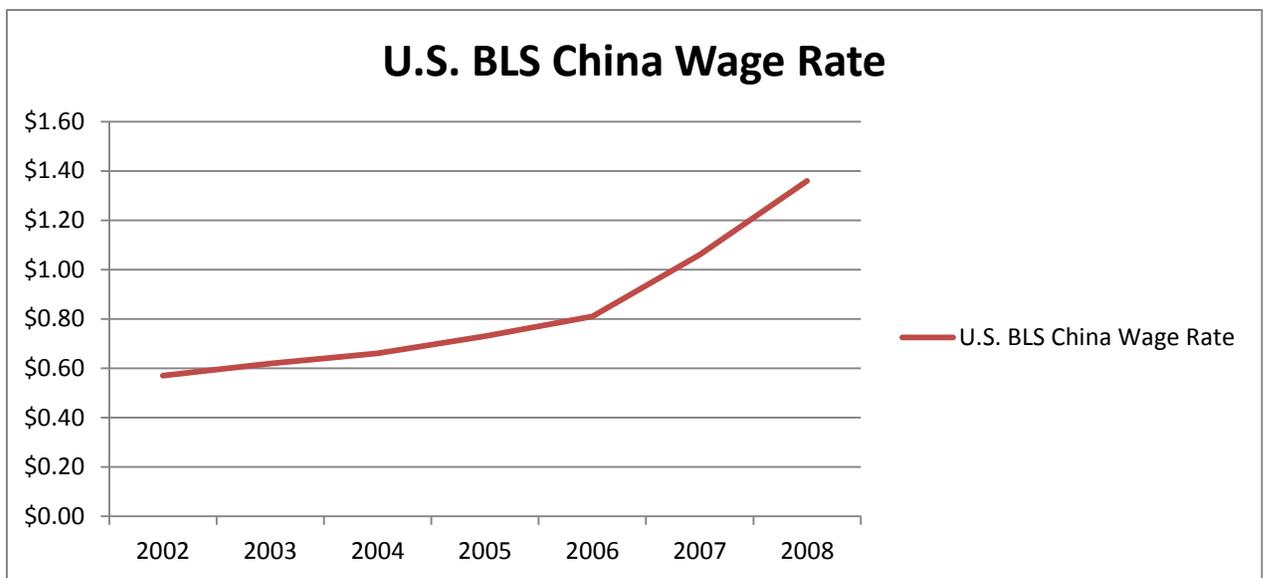
References

What international buyers need to know about the costs of labor in China.

Where is the future of sourcing in the Asia? I believe the primary destination is still in China and will remain that way for many years to come, however, many wonder if the continual rise in labor rates will make other Asian countries more attractive for sourcing. I assert, that although the average labor costs in China are undoubtedly increasing, the actual affect it has on sourcing costs are over exaggerated.

From 2002 until 2008, the U.S. bureau of labor statistics shows that the average hourly labor rate in China has gone from \$.57usd to \$1.36usd (42%), with the single biggest leap coming from 2007 to 2008 <http://www.bls.gov/fls/china.htm>.

Table 1. Hourly compensation costs of manufacturing employees in China, 2002-2008



More recent data proves difficult to obtain, due to the lack of information coming from Beijing, however, it's safe to say, the trend continues upwards.

The Boston consulting group (BCG) estimates that the wage rate in 2010 to be \$1.99 and by 2015, the average hourly wage rate will be up to \$4.41. The rising labor rates are somewhat offset by the increased manufacturing productivity levels in China and BCG estimates that in 2000, the relative productivity rate per

worker was 13% of a worker in the U.S. and in 2010 that number was 29%. BCG estimates by 2015, the productivity in China will be up to 38% of a U.S. worker.

A breakdown shows that productivity growth rate is not nearly as explosive as the increasing wage rate. Productivity seems to be increasing at half the pace of wage rates.

If [BCG's study](#) is accurate, from 2010 to 2015, the wage rate will have increased 121%, while the labor productivity will have increased 31%. So, the wage rate would top the increased productivity rate by a multiple of 3.9.

It is clear that increasing productivity will not totally offset the increasing the wage rates. However, productivity increases will help ease the burden of increasing costs. Also helping to ease the burden of increasing labor costs is the improving infrastructure in China which allows for easier access to the manufactured goods.

In order to measure the true impact of wage rates across China, reasons behind increasing wages need to be examined further.

Figure 1.

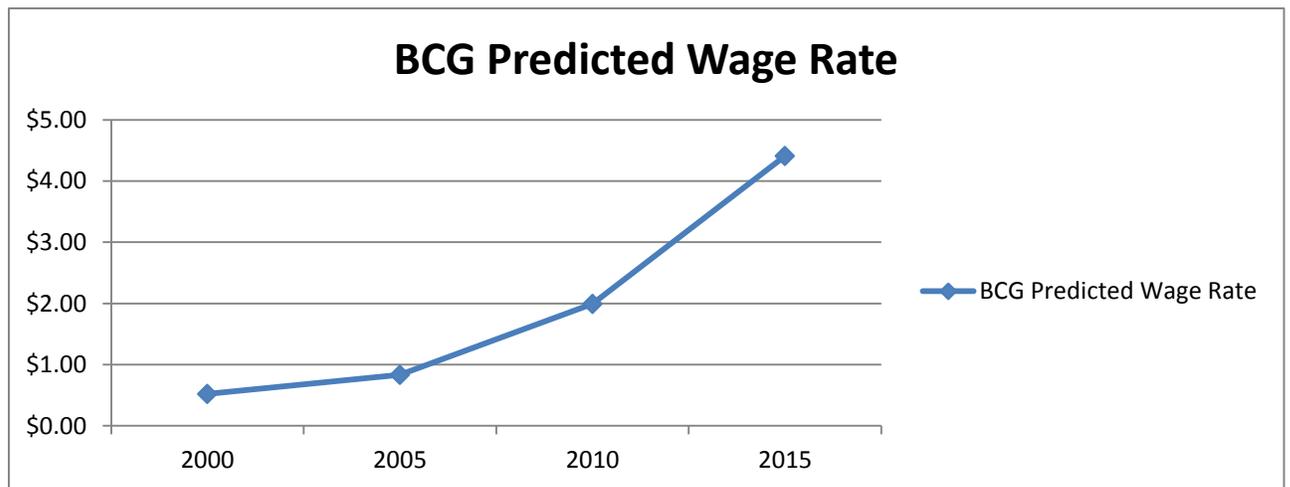
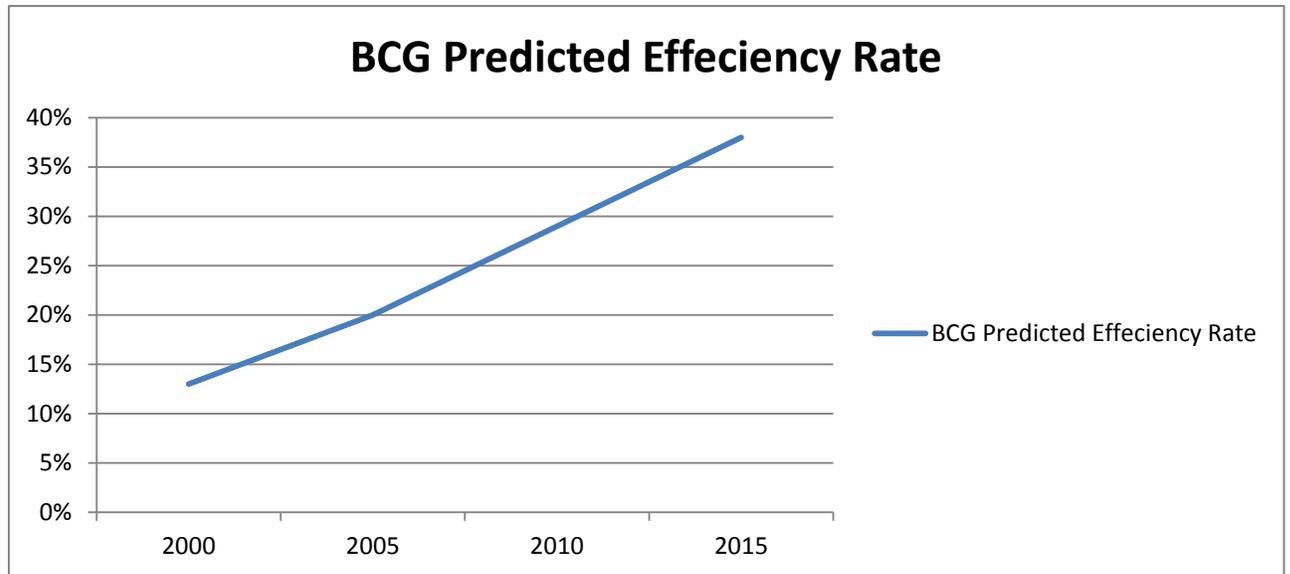


Figure 2.



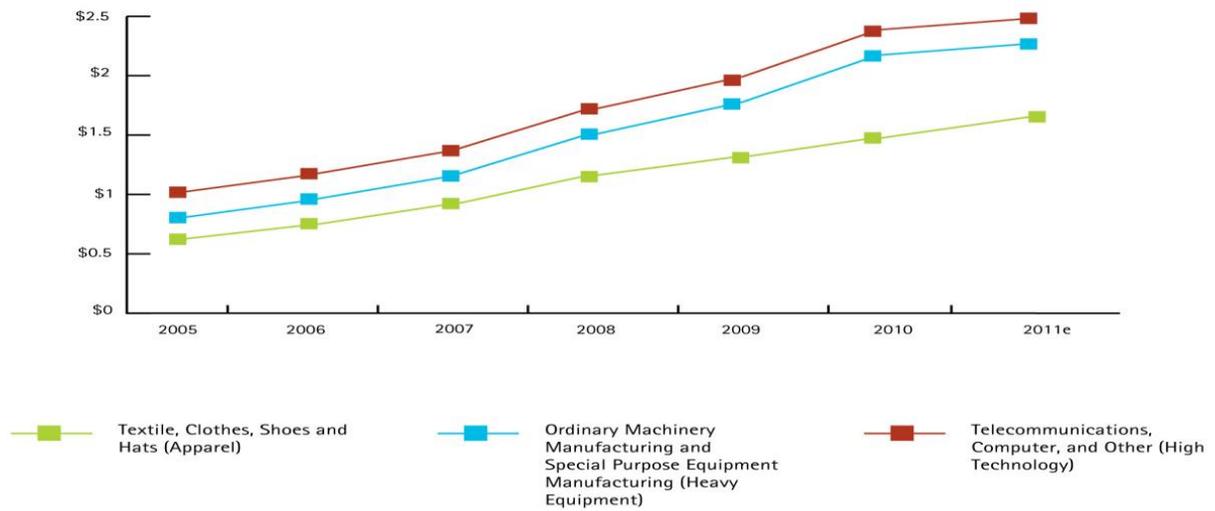
The main driver for the increasing labor rates are the tier one Chinese coastal cities such as Shanghai, and Shenzhen. The wages in the interior of China, where cost of living and general worker education level are lower, increase at a significantly slower pace.

Doom and gloom for China Sourcing? Hardly.

One reason for the increased labor costs is the increases in manufacturing which requires skilled labor. In the recent past, a high majority of sourcing to China was for industries which required unskilled workers. However, in 2012, manufacturing operations in China are increasingly demanding skilled workers, who demand a higher wage rate.

Therefore, don't look at the average wage rate without critically thinking about what drives the "average." Unskilled labor rates, especially in mid and western China, away from the coast, are not rising at the same pace of the "average." A [recent report by Accenture](#), estimates the average wage rate for industries which require more unskilled workers (textiles) in China to be only around 60% to that of industries which typically require a more highly skilled worker (machinery).

Figure 3: Average hourly wage in China by industry (in US dollars per hour)



While the combined coastal and interior average wage rate increases in China far outpaces those of its ASEAN neighbors, the wages for unskilled industries, which still is increasing at a higher rate than most ASEAN countries, is far less dramatic. What does all this mean? If you're planning to move your sourcing out of China because of fear of increasing labor rates, know the average wage rate can be a misleading statistic.

The primary reason for the lower wage rates in most ASEAN countries can be found in the type of work (unskilled) that is done there. So when comparing labor rates, compare apples to apples, instead of looking at somewhat misleading "average labor rate" statistics.

Price vs. Cost

Although labor rates are an important statistic in making a decision on where to source your manufacturing, it is only one factor. The greater issue is over-all-cost, which is derived from many more factors than just labor costs. Costs of logistics are also a major factor and no other ASEAN country has the infrastructure or experience of China, which has built its burgeoning economy on exports. For example, the port system in China is superior to that of any ASEAN country simply because of the massive volume leaving Chinese ports on a yearly basis.

The Chinese have been forced to improve their systems and infrastructure to keep up with demand.

Tap the domestic market

Having your products manufactured in China is an enormous advantage when trying to sell to the Chinese market. The logistics costs are minimized and you avoid tariffs while also gaining the favor of the government. Many pharmaceutical companies have succeeded in posting their drugs on the approved list for the Chinese national health system, simply because they manufacture in China. There are many more examples of foreign producers moving their manufacturing to China or sourcing to China just to tap the Chinese market. Although other ASEAN countries also have a large population base, none can compete with the China market.

Conclusion

In summation, the “average costs of labor” is a statistic that plays just one part in the overall costs of manufacturing in China. When one looks closely, it’s easy to see the opportunity to move west in China to minimize the increasing costs of the coastal cities. With a critical eye, it’s also possible to see that the average labor rate is not a simple statistic and is driven by many factors, such as the extreme rise in coastal labor rates and the demand for more costly skilled labor. More importantly, the costs of low skilled workers, which is what have many attracted to other ASEAN countries, is not spiraling out of control as many proponents of sourcing to ASEAN countries would point out.

Continue sourcing in China knowing that it still offers the best infrastructure, the highest skilled workers and possesses an underutilized labor force in its interior.

Recommended Reading (follow the links)

[Labor Shortage in China](#)

[Heavy hitters weigh in on future of China Sourcing](#)

What lawn mowing methods tell us about the costs of labor in China

Reports of China's death as a sourcing destination are highly exaggerated.

New policy helps Chinese suppliers reduce costs. Will it be passed on to buyers?

China's manufacturing slowdown. Why it's GOOD news for us buyers.

Exclusive look at data from one of the largest Chinese supplier surveys ever conducted

Further evidence that there is no "next China"



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[The Essential Reference Guide to China Sourcing \(chinasourcinginfo.org/book/\)](http://chinasourcinginfo.org/book/)

Written by CSIC board member, Mike Bellamy, this book offers additional tools and strategies for finding and managing suppliers and service providers in China.

