



Upstreamness, exports, and wage inequality: Evidence from Chinese manufacturing data[☆]



Bo Chen

School of Economics, Huazhong University of Science and Technology (HUST), 1037 Luoyu Rd., Wuhan, China

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ABSTRACT

In this paper we investigate within-firm wage inequality across heterogeneous industries that hold different positions in the domestic value chain, and across heterogeneous firms that have different exposure to trade. We find that the wage inequality problem is more severe in upstream industries than in downstream ones, and among firms with greater exposure to trade (i.e., larger export share of sales). Our findings support both classic and new trade theories on wage inequality. In downstream industries where Chinese firms are typically engaged in processing and assembly work with intensive use of unskilled labor, trade leads to less wage inequality within firms. However, trade also introduces pro-competitive effects which usually benefit exporters and their skilled labor. The results hold after various checks and controls for robustness.

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1. Introduction

Over the recent two decades, China has undergone salient growth and liberalization in its international trade sector. Now China has taken a major global role in manufacturing which led to its so called “world’s factory” designation. The trade liberalization effect manifested itself after 2001 when China entered the WTO. One of the features in China’s trade activity is that China serves as a “middle supplier” on the global value chain whose trade is closely related to intermediate products. Fig. 1 shows that during 1997–2008 around 40% of China’s international trade was directly classified as “processing trade” and a significant part of the remaining was also closely related to intermediate goods (Manova and Yu, 2012). China’s manufacturing structure fundamentally changed after it entered the WTO (Jing, Head, & Swenson, 2014).

Meanwhile, China’s labor market also has experienced profound changes since the mid-1980s when China started to gradually loosen its restriction on labor mobility. An increasing number of farmers, attracted by the much higher compensation, quickly moved into the manufacturing sector in urban areas. They are usually referred to as migrant rural workers. According to Cai (2010), the number of rural workers¹ was about 225 million in 2009. About 63% of those workers

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E-mail address: chenbo1947@gmail.com (B. Chen).

¹ Rural workers are defined as the former farmers who work more than 6 months in nonagricultural sector.

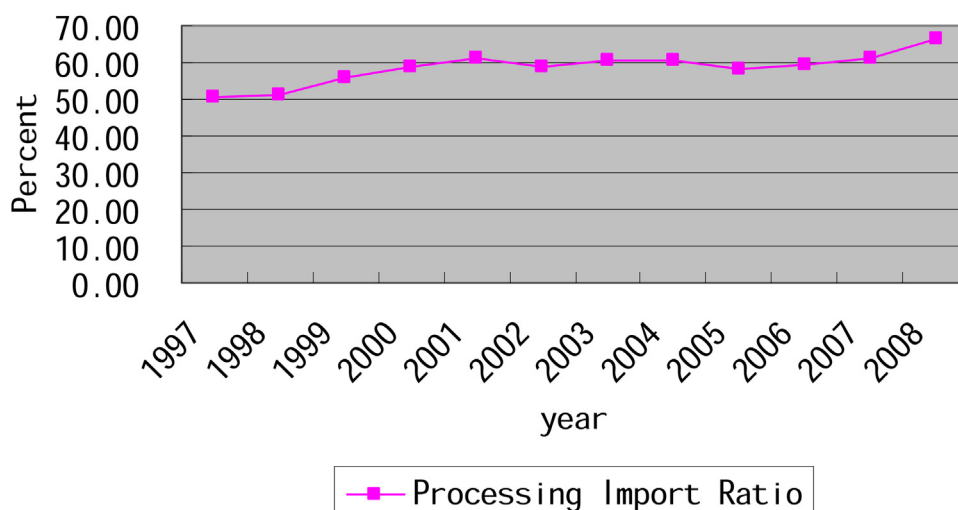


Fig. 1. Processing Import Share in China: 1997–2008.

Source: China's Custom General Office: 1997–2008.

chose to work in their urban area rather than in their rural neighborhood. Such abundant labor supply effectively keeps China's unskilled labor wage at a fairly low level, thus making China's labor intensive products very competitive in the world market. Because of the huge benefit from cheap unskilled labor as well as global trade liberalization, China has experienced steady rapid growth in international trade and has emerged to be one of the largest trading countries in the world. Simultaneously, the wages paid to skilled workers has seen a very fast increase, particularly among exporting companies and multinational corporations. Internationally competitive wages have attracted high skilled labor, previously working in the developed countries, to return to China, making China change from a country with net "Brain Drain" before 1990s to "Brain Circulation" after 2000 (Chen, 2009).

At the same time, the income inequality problem has become exacerbated in China. China's National Bureau of Statistics (NBS), reports that the GINI coefficient was 0.34 in 1990 but exceeded 0.47 in 2008 according to the World Bank. Besides wealth income, the income inequality is primarily caused by the wage inequality between the skilled and the unskilled labor force.

It has been suggested that trade liberalization is the key reason for the growing wage inequality between skilled and unskilled workers in China. For example, based on 1500 Chinese firms from 1998 to 2000, Li and Xu (2008) find that international trade led to a net increase in the relative demand for skilled labor, which in turn implies a higher wage inequality.

However, wages of the rural workers (i.e. the unskilled labor) in China have increased substantially since China joined the WTO in 2001 (which led to a surge in trade in China). For example, both Nike and Adidas closed their factories in China before 2013 due to the quickly increasing unskilled labor cost. According to the China Rural Household Annual Survey, the nominal wages for rural workers increased by almost 50% from 2003 to 2008, or almost 30% in real terms (Cai, 2010). According to Cai (2010), China has already passed the Lewis Turning Point since 2003 and the unskilled labor supply is no longer highly elastic as it was before 2000.

Under globalization, international production fragmentation has been transforming countries' domestic value chain such that enterprises have become more specialized in some particular parts of the production chain before the final products are completed. The typical stages to accomplish a final product are: market research, idea forming, development of technology, module designation, assembly processing, marketing, and after-sales service. These stages form a value chain, also known as a supply chain. As the largest developing country, China participates in the global value chain in many ways due to a wide variety of entities, including subsidiaries established by multinational corporations via direct investment, joint venture, etc. The increasing presence of such firms not only affects China's trade, but also fundamentally reshapes China's domestic value chain. Given that different stages of the value chain demand different intensities of factors, the reshape due to globalization may therefore also profoundly affect wage inequality between the skilled and the unskilled labor. Therefore, in this paper we investigate within-firm wage inequality by linking it to firms' positions in the value chain (both upstream and downstream positions) and its exposure to trade (i.e. globalization).

Since the 1980s, trade economists have been debating whether trade liberalization leads to wage inequality and whether the factor price equalization (FPE) theorem of the Heckscher-Ohlin (H-O) model can help to explain the increasing wage inequality in the U.S. and many other countries in the Organisation for Economic Co-operation and Development (OECD). For example, Johnson and Stafford (1993) and Leamer (1993, 1996) argue that FPE can explain the wage inequality between skilled and unskilled workers in the U.S. However, Lawrence and Slaughter (1993) checked historical data on the prices of labor-intensive goods and capital intensive goods. They found that the movement of the relative prices of these two types of

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