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Changes in China Could Raise Prices Worldwide

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

Coastal factories are raising salaries, local governments are hiking minimum wage standards and if China allows its currency, the renminbi, to appreciate against the U.S. dollar later this year, as many economists are predicting, the cost of manufacturing in China will almost certainly rise.

Although the salaries of factory workers in China are still low compared to those in the United States and Europe (the minimum wage in southern China is close to $125 a month), economists say the changes will eventually ripple through the global economy, driving up the prices of everything from T-shirts and sneakers to computer servers and smart phones.

“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 dramatized Sunday, when Foxconn Technology, one of the world’s largest contract electronics manufacturers and the maker of everything from the Apple iPhone to Dell computer parts, said that within three months it would double the salaries of many of its assembly line workers.

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

Taiwan-based Foxconn, which has more than 800,000 workers in China, said the salary increases are meant to improve the lives of its workers.

Last week, the Japanese auto maker Honda said it had agreed to give about 1,900 workers at one of its plants in southern China raises of between 24 percent and 32 percent in the hopes of ending a two week-long strike, according to people briefed on the agreement.

The changes are coming about because of the growing clout of workers in China’s sizzling economy, analysts say, and because soaring food and housing prices are eroding the spending power of migrant workers.

But there are other reasons. Analysts say Beijing is backing wage increases as a way to spur 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 policymakers also favor higher wages because they could help ease a widening income gap between the rich and the poor.

Last Thursday, the Beijing municipal government said it would raise its minimum wage 20 percent to about $140 a month; several other cities are preparing to implement similar increases.

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 — is about five percent a month, meaning that an astounding 20,000 workers are leaving every month and need to be replaced.

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

“Demography will do what the Strategic & Economic Dialogue hasn't: raise the cost of Chinese goods,” he said, referring to U.S.-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 re-pegged the renminbi to the dollar. That was a way to protect exporters.

Even though labor accounts for a small percentage of the final cost of many products, salary increases are expected to affect much of the supply chain and force companies to raise prices.

For many exporters, 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.

Still, 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 spur domestic consumption.

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

Rising labor costs here aren't 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.”