THE NEW LABOUR LAWS ARE NOT
THE REAL PROBLEMS FOR THE PRC, EXPORT INDUSTRY

Contrary to popular belief, the new Labour Contract Law, now a fait accompli in the People's Republic of China (PRC), being distinct and separate from the Hongkong Special Administrative Region (HKSAR) of the PRC, is unlikely to have very much of a financial effect on exporters of goods from the Middle Kingdom.

The rapid depreciation in the translation value of the US dollar vis-à-vis the euro, the Japanese yen and renminbi, as well as record prices for crude oil on international commodity exchanges are much-more worrying concerns.

While PRC industries' export profits are almost guaranteed to shrink, during the remainder of this year, the reduced growth rate will not be due to the imposition by the Government of the PRC of the new labour laws.

Because the new labour laws are but a tickle, compared with other problems, surfacing almost daily, now, and, in any case, the new laws are not likely to have much of an impact for at least the next few years – if at all.

The newly imposed Labour Contract Law requires Management, inter alia:

1. To give workers formal contracts of employment;

2. The rights of labour to collective bargaining;

3. Overtime pay for workers will have to be defined, explicitly; and,

4. Termination of workers' employment will require Management to pay compensation, in most cases.

The above laws will affect some 100 million rural, migrant workers, most of whom work in construction and simple manufacturing entities in the PRC, proper – shoes, garments, leather goods, etc.

Prior to the imposition of the new labour laws, there were only informal, mostly verbal contracts between Management and labour.

The new laws will add between 10 percent and 15 percent to manufacturing costs, according to present estimates.

Exporters of goods from the PRC will have to shoulder these costs and enterprises, engaged in the production of such things as garments, will feel the brunt of the new labour laws, but only down the line, not today.

The PRC is, still, the world's tailor shop and this industry is very labour intensive.

How the growth of labour-intensive industries will be affected in 2008 will depend on a number of factors, but increased labour-related costs are but a small cross to bear, it appears to **TARGET** ().

The Reasoning

The slowdown in the growth of the economies of the US and Europe will, definitely, affect exports from the PRC, proper.

This is a given and requires no further elaboration.

This slowdown will result in lower profits for PRC exporters to both the US and Europe for the next few years – at least.

Mind you, there will be growth, but not to the extent of the past 5 years of record-breaking growth.

The economic slowdown in the US and Europe, as is very clear, has nothing to do with the new, PRC labour laws that were recently introduced.

Over the past decade or so, one has seen rural migrant workers of the PRC flood to places, such as Guangdong Province, in order to take advantage of the ever-increasing, economic explosion of the region.

Rapid demand growth of semi-skilled workers resulted in demands by PRC workers for higher pay and better working conditions – supply-demand factors kicked in as one would expect in any economy.

Management was forced to accede to the demands of labour.

The result: Workers' wages rose by between 15 percent and 30 percent, over a period of about 6 years, from 2000 to about 2006.

While this was taking place as a natural result of market forces, the translation value of the renminbi vis-à-vis the US dollar appreciated.

The renminbi appreciated against the US dollar by about 6 percent in 2007, alone.

Prior to 2005, the renminbi had been pegged to the US dollar so that PRC exporters were not affected by foreign-currency appreciation/depreciation to any great extent.

For the past 5 years, therefore, PRC exporters were suffering, somewhat, from demands by labour with regard to semi-skilled, rural workers, who sought, and obtained in most cases, wage increases at the compound rate of about 4 percent per annum.

And labour costs are continuing to rise and would have continued to rise even without the imposition of the new labour laws.

Management of PRC exporters, in the past, was able to cope with demands from labour by:

1. Adjusting methods by which products were manufactured;

2. Adopting labour-saving technology; and/or,

3. Passing on additional manufacturing costs down the line to importers/wholesalers.

The production of garments, footwear, toys and furniture from the PRC is very big business, when taken as a whole, and so it was not too difficult to pass on costs to customers in the US and Europe: PRC exporters had the whip hand.

But there are big changes, taking place in the US and Europe, today, and demand for the above goods is waning.

The demand for PRC products has slowed, appreciably, since 2003 when the growth of PRC exports was about 25 percent, Year-On-Year.

But during the second half of 2008, export growth from the PRC could well fall to single digits due to the economic slowdown in the 2 major markets of the PRC – the US and Western Europe.

Also, in the second half of 2008, it is quite likely that there will be an accelerated increase in the appreciation of the renminbi vis-à-vis the US dollar, probably by as much as 10 percent.

In US dollar terms, therefore, taking all of the above into consideration, wage inflation is set to run at about 20 percent, this year.

In summary, therefore, PRC exporters are looking at slower export growth while manufacturing costs continue to rise.

And it is unlikely, this time around, that Management will be able to pass on all of the additional manufacturing costs to customers.

Profit margins of PRC exporters will be hit … and hit hard.

<u>Conclusion</u>: Clearly, the new labour laws, introduced by the PRC Government, which came into force this year, are irrelevant and insignificant, at this time, when weighed against all of the other problems, surfacing on the financial horizon.

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