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Foreign Direct Investment and Wage Inequality: The Case of China

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Abstract: China is the second largest recipient of FDI inflows nowadays, a preferred destiny for the global investors after USA. In study, FDI is said to be creating a favored local group depending on skill intensities, it requires and if the investment is technologically advanced than the host country's state, then this can lead to greater income disparity. China is evidenced with a spectacularly huge FDI inflow in the past decade along with increasing income inequality. This study attempts to analyze, whether FDI inflows in China has any role in increasing inequality over time. Finding of this study is quite clear: foreign funded industries in China are enjoying persistently higher wages than the national averages and the higher the skilled intensive foreign investment is the higher is the wages.

Key words: FDI, wages, skilled labour, unskilled labour, inequality, industries, literature

INTRODUCTION

Foreign Direct Investment (FDI) is defined as a long-term investment by a foreign direct investor in an enterprise resident in an economy other than that in which the foreign direct investor is based. The FDI relationship consists of a parent enterprise and a foreign affiliate, which together form a Transnational Corporation (TNC). In order to qualify as a FDI the investment must afford the parent enterprise control over its foreign affiliate. The UNCTAD defines control in this case as owning 10% or more of the ordinary shares or voting power of an incorporated firm or its equivalent for an unincorporated firm (http://unctad.org).

Foreign Direct Investment (FDI) has the potential to generate employment, lift up productivity, transfer skills and technology, enhance exports and contribute to the long-term economic development of the world developing countries. As UNCTAD reports:

- Foreign affiliates of some 64,000 Transnational Corporations (TNCs) generate 53 million jobs
- FDI is the largest source of external finance for developing countries
- Developing countries inward stock of FDI amounted to about one third of their GDP, compared to just 10% in 1980
- One-third of global trade is intra-firm trade (www.unctad.org/report/foreign_direct_investment)

It thus, becomes a common agenda in the development economy's policies to attract foreign direct investment, often competing each other with scores of incentive packages.

Foreign direct investment can take different forms namely:

Greenfield investment: Greenfield investments are the investments, which attempt to build in new facilities or the expansion of existing facilities. Greenfield investments are the primary target of a host nation's promotional efforts, because they create new production capacity and jobs, transfer technology and know-how and can lead to linkages to the global marketplace. However, it often does this by crowding out local industry; multinationals are able to produce goods at lower cost (because of advanced technology and efficient processes) and uses up resources (labor, intermediate goods, etc). Another downside of greenfield investment is that profits from production do not feed back into the local economy, but instead to the multinational's home economy. This is in contrast to local industries, whose profits flow back into the domestic economy to promote growth.

Mergers and acquisitions: It comprises transfers of existing assets from local firms to foreign firms takes place; the primary type of FDI. Cross-border mergers occur, when the assets and operation of firms from different countries are combined to establish a new legal entity. Cross-border acquisitions occur when the control of assets and operations is transferred from a local to a foreign company, with the local company becoming an affiliate of the foreign company. Unlike greenfield investment, acquisitions provide no long term benefits to the local economy-even in most deals the owners of the local firm are paid in stock from the acquiring firm, meaning that the money from the sale could never reach the local economy. Nevertheless, mergers and

acquisitions are a significant form of FDI and until around 2004, accounted for nearly 90% of the FDI flow into the United States, the world's number one FDI receiving country (www.unctad.org/report/foreign_direct_investment). Mergers are the most common way for multinationals to do FDI.

Impact of FDI: A literature review: The contribution of FDI to economic development has been debated quite extensively in the literature. The 'traditional' argument is that an inflow of FDI improves economic growth by increasing the capital stock, whereas recent literature points to the role of FDI as a channel of international technology transfer. There is growing evidence that FDI enhances technological change through technological diffusion, for example, because multinational firms are concentrated in industries with a high ratio of R and D relative to sales and a large share of technical and professional workers (Markusen, 1995). Multinational corporations are probably among the most technologically advanced firms in the world. Moreover, FDI not only contributes to imports of more efficient foreign technologies, but also generate technological spillovers for local firms. In this approach, technological change plays a pivotal role in economic growth and FDI by multinational corporations is one of the major channels in providing Developing Countries (LDCs) with access to advanced technologies (Robert and Oliver, 2001). The knowledge spillovers may take place via imitation, competition, linkages and/or training (Robert and Oliver, 2001). Although, it is in practice rather difficult to distinguish between these four channels, the underlying theory differs.

The imitation channel is based on the view that domestic firms may become more productive by imitating the more advanced technologies or managerial practices of foreign firms (depending on the technology gap). In the absence of FDI, acquiring the necessary information for adopting new technologies is too costly for local firms. Thus, FDI lowers the cost of technology adoption and may expand the set of technologies available to local firms.

The competition channel emphasises that the entrance of foreign firms intensifies competition in the domestic market, encouraging domestic firms to become more efficient by upgrading their technology base.

The linkages channel stresses that foreign firms may transfer new technology to domestic firms through transactions with these firms. By purchasing raw materials or intermediate goods a strong buyer-seller relationship may develop that gives rise to technical assistance or training from the foreign firm to the domestic firm.

Finally, the training channel arises if the introduction of new technologies requires an upgrading of domestically available human capital. New technologies can only be adopted, when the labour force is able to work with them. The entrance of foreign firms may give an incentive to domestic firms to train their own employees. If labour moves from a multinational to a local firm (through labour turnover), the physical movement of workers causes knowledge to move between firms (Robert and Oliver, 2001).

Empirical evidence that FDI generates positive spillovers for local firms is mixed (Saggi, 2000). Some studies find positive spillover effects, some find no effects and some even conclude that there are negative effects (Aitken and Harrison, 1999). This does not necessarily imply that FDI is not beneficial for growth (De Mello and Luiz, 1997). It may be that the spillovers are of a different nature. Aitken *et al.* (1997), for instance, point to the importance of the entry of multinationals for reducing entry costs of other potential exporters. Moreover, FDI may also contribute to growth by means of an increase in capital flows and the capital stock.

Some recent studies have argued that the contribution of FDI to growth is strongly dependent on the circumstances in recipient countries. Balasubramanyam *et al.* (1996) find that the effect on growth is stronger in countries with a policy of export promotion than in countries that pursue a policy of import substitution. Borensztein *et al.* (1998) suggest that the effectiveness of FDI depends on the stock of human capital in the host country. Only in countries, where human capital is above a certain threshold does FDI positively contribute to growth. Borensztein *et al.* (1998) develop a growth model in which technical progress, a determinant of growth is represented through the variety of capital goods available. Technical progress is itself determined by FDI as foreign firms encourage adoption of new technologies and increases the production of capital goods hence, increase variety. Thus, FDI leads to growth via technology spillovers that increase factor productivity. Certain host country conditions are necessary to ensure the spillover effects. In particular, human capital (an educated labor force) is necessary for new technology and management skills to be absorbed.

MATERIALS AND METHODS

The social and distributional impacts of FDI are also a point of debate, although the distributional effect depends principally on host country policies and institutions. For example, employment outcomes depend on the flexibility of the labor market (Asian Development

Outlook, UNCTAD). The comparative advantage theory indicates that when capital flows to developing countries, income is redistributed from labor to capital, as total and average returns to labor increases (Borensztein *et al*., 1998). However, many new foreign investments in developing countries are in process manufacturing because of lower labor costs, such as Nike's shoe factories across developing Asia. The host countries often import unfinished components and export finished goods or refined components for further processing elsewhere. While, wages may rise throughout the work force in host countries and reduce income disparity, in practice wages are likely to rise only for a small fraction of the labor force employed by the foreign investor. By creating a favored local group, this can lead to greater income disparity within the host country. Generally, this favored group belongs to neither to the lowest nor the highest income group. The result can be to improve the absolute and relative condition of workers within this favored group in the process aggravating income inequality in society (Asian Development Outlook, UNCTAD). Thus, we see that there is no straight forward conclusion about the role of FDI in the income distribution of an economy.

There are quite a good numbers of models explaining how the FDI outflow and outsourcing aggravates wage inequality in the source country. One of the models highly circulated is of Feenstra and Hanson (2003).

Feenstra and Hanson (2003) explain that trade in intermediate inputs affects labour demand in the industries that use these inputs. Since the US and other industrialized countries have comparative disadvantage in low skilled labour intensive inputs, outsourcing occurs in this area. Thus, outsourcing shifts demand away from low-skilled activities and consequently a fall in their relative wages becomes inevitable. The Feenstra-Hanson model of outsourcing can be simply summarized as follows.

Let, there are three activities in the industry: the production of an unskilled-labor intensive input, say y_1; the production of a skilled-intensive input, denoted by y_2 and the bundling together of these two goods into finished product. The two inputs are produced using skilled Labour (L_i), skilled labour (H_i) and capital (K_i), i = 1, 2. The long run cost functions are given by:

$$C_i (w, q, r, Y_i) \equiv wL_i + qH_i + rK_i \quad (1)$$

Where:

w = The wage of unskilled labour
q = The wage of skilled worker
r = The rental on capital

The zero profit conditions for activities 1 and 2 are given as:

$$p = c_1 (w, q, r) \text{ and } 1 = c_2 (w, q, r) \quad (2)$$

assuming price of the skilled intensive exported input y_2 as numeraire and the price of the unskilled labour intensive imported input y_1 as p.

Totally, differentiating Eq. 1 and 2 using Jones' algebra we get:

$$\begin{aligned} p^\wedge &= \theta_{1L} w^\wedge + \theta_{1H} q^\wedge + \theta_{1K} r^\wedge, \\ 0 &= \theta_{2L} w^\wedge + \theta_{2H} q^\wedge + \theta_{2K} r^\wedge \end{aligned} \quad (3)$$

Where:

θ_{ij} = The cost share of factor j in activity i, with $\Sigma\theta_{ij} = 1$
$^\wedge$ = A variable's growth

For simplicity Feenstra and Hanson (2003) assume the cost share of capital in the two industries are equal, so that $\theta_{1K} = \theta_{2K}$. We can then take the difference of the two equations in Eq. 3 to obtain:

$$\begin{aligned} p^\wedge &= (\theta_{1L} - \theta_{2L}) w^\wedge + (\theta_{1H} - \theta_{2H}) \\ q^\wedge &= (\theta_{1L} - \theta_{2L}) (w^\wedge - q^\wedge) \end{aligned} \quad (4)$$

where, the second inequality follows from the fact that with equal cost share of capital, the total costs share of labour are also equal, so that:

$$(\theta_{1L} + \theta_{1H}) = (\theta_{2L} + \theta_{2H}) \rightarrow (\theta_{1L} - \theta_{2L}) = -(\theta_{1H} - \theta_{2H})$$

Rearranging Eq. 4, we get:

$$(w^\wedge - q^\wedge) = p^\wedge / (\theta_{1L} - \theta_{2L}) \quad (5)$$

With activity 1 assumed to be unskilled-labour intensive, we have $(\theta_{1L} - \theta_{2L}) > 0$. Thus, Eq. 5 says that with outsourcing, a decrease in the price of imported intermediate input that is $p^\wedge < 0$, leads to a decrease in the relative wage of unskilled labour.

The discussion, however, about the FDI impact on the destination country's wage is not so straightforward. But from Mondorf (2007), we can recall the value chain model. Accordingly, the advanced country is always moving up the value chain. The emerging country, on the other hand, could move one step up in the value chain. For example, if the emerging country is earlier producing the primary skilled product C can now move up to produce intermediate skilled product B. In this way, there is a skill upgradation in the emerging economy. Essentially, this will increase labour productivity in the host country and wages in this industry as well. If FDI inflow takes the form to produce the good up in the value chain, then it is quite

logical that the host country might also have to have increasing wage inequality at least in the short run.

FDI and wage inequality in China: FDI inflow to China is not something new. From the 1970s, China experienced FDI inflows but it takes a momentum during the second half of the 1990s. At present China is the most successful developing country in attracting FDI and its second in the world after USA. Table 1 summerizes, the FDI inflows and outflow to and from China in the past decade. It shows that there is a gradual and continuous increase in the FDI inflows. This implies that China is consistently chosen by the foreign investors as their potential destiny for outsourcing. It is point to notice that China has a considerable amount of FDI outflow too as shown in Table 1.

For example in 2005, FDI outflow is over 11 billion USD, which is substantial comparing to other developing countries. Although, the outflow displays some fluctuation but the overall trend is increasing.

Table 2 shows, the comparison of FDI flows of the most successful countries in attracting FDI in the years 1995-2005. USA is the most attractive destiny and a source of FDI flows in the world with over 1527 billion USD inflow and 1354 billion USD outflow during the period 1995-2005. While China is the second most attractive destiny in terms of getting FDI inflows with an amount of 537 billion USD in the same time span. The other Asian countries competing with China, namely India, Thailand and Malaysia are able to attract FDI inflows like 44,37 and 44 billion USD which are <10% of what China amounts. China's FDI outflow during this period (over 34 billion USD) is even closer to the FDI inflows of these Asian rivals.

During the last few years China also is going through a passage of increasing income inequality. The Gini coefficient in Table 3 could be noticed, which shows a clear positive trend over time. There might be many things including inflation rate, terms of trade effect, skilled biased technological change (with or without FDI inflows), labour reforms, government transfer reforms etc behind the scene.

The Gini coefficient is not however, a direct measurement of wage inequality, which is the focus of this study. Anyway, Table 1 and 3 show that China is experiencing both an increasing FDI inflow and increasing inequality over the past decade. But it is not quite clear whether FDI inflow is contributing to aggravate this inequality remains unanswered. One possible way to link these two could be running some form of regressions based on specific models. But since, China's FDI inflow takes the momentum from 1995-1996, we have insufficient observations to do so and since there, is also no available data measuring wage inequality, we can not simply relate them. We can rather go for an indirect way of linking these twos. The rest of the study serves for this purpose.

First of all, let us talk why China expose itself desperate in attracting FDI inflow? Is there any financial reason? Table 4 shows that China enjoys positive current account balance with a continuous increasing trend. In 2006, the current account balance is 184 billion USD, which is for example, over 7% of its GDP.

All these clearly reveal the fact that China is not looking for foreign currencies just to import machineries or raw materials for production, while attracting FDI.

This is also not the case that China has very low domestic savings-capital formation. Rather Table 5 displays that savings-capital formation in China is spectacularly high. Total capital formation in 2006 is projected to be 44% of it's GDP, while that of gross national savings is 51% and importantly these rates also show an increasing trend over time. It implies that there might be and of course, some non-financial motives like endeavor for better technology, market access, management expertise and so on behind china's quest for FDI.

Now let us see the role of foreign direct investment in China's employment and wages. We show in Table 6, the urban employment scenario in China. The share of foreign funded industries in urban employment is around 4% in 2004. That is quite low, no doubt, but in determining wages for the skilled labour it is not the quantity rather the marginal wage of labour that is important (Xiaodong, 2002). The growth rate of employment in the foreign funded industries, however is tremendous, around 20% in 2004. While the state-owned and the urban-collective owned industries suffer a negative growth during the period 2001-2004. This is clear from Fig. 1 that the urban employment is solely driven by the positive growth in foreign funded employment.

For the wage scenario in industries with different ownership we can show on Table 7. It shows that wages in foreign funded industries is much higher than the national, followed by state owned and the urban collective owned industries. And importantly the gap is widening over time. From Table 7 and 8, it is not implausible to conclude that FDI might have a role in aggravating the increasing inequality in China as is evident from the Gini coefficient in Table 3.

This increasing wages at the foreign funded industries also might be the factor behind the scene why employment in the state owned and urban collective owned industries are shrinking, while that in foreign funded industry is increasing. The wage in the foreign

Table 1: FDI flows to China (million USD)

FDI	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Inward	37521	41726	45257	45463	40319	40715	46878	52743	53505	60630	72406
Outward	2000	2114	2562	2634	1774	916	6885	2518	-152	1805	11306

World investment report; IMF

Table 2: World FDI flows in 1995-2005 (million USD)

Category	USA	Canada	Mexico	Brazil	Singapore	Malaysia	Thailand	India	China
Inward	1527,664	237,548	171,507	206,806	143,613	44,654	37,109	44,437	537,161
Outward	1354,184	305,561	21,660	21,366	81,354	21,816	4,171	8,897	34,363

World investment report; IMF and own calculation

Table 3: Gini coefficient (%)

Years	1996	1997	1998	1999	2000	2001	2003
Gini	33.4	33.9	34.4	36.3	37.2	44.73	46.0

Statistical year book of China: Various issues and World Bank

Table 4: Current account balance of China

Scal	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
US dollars (billion)	1.6	7.2	34.4	31.6	15.7	20.5	17.4	35.4	45.9	68.7	160.8	184.2
Percent of GDP	0.2	0.8	3.6	3.1	1.4	1.7	1.3	2.4	2.8	3.6	7.2	7.2

World economic outlook; IMF

Table 5: Savings and capital formation of China (GDP (%))

Years	2001	2002	2003	2004	2005	2006 (projected)
Total capital formation	34	35	38	39	40	44
Gross national savings	35	38	41	43	47	51

World economic outlook; IMF

Table 6: Urban employment in China by ownership

	Employment by ownership (10,000 persons)					Growth rate (%)			
Sectors	2000	2001	2002	2003	2004	2001	2002	2003	2004
Urban employed persons	23151	23940	24780	25639	26476	3.41	3.51	3.47	3.26
State-owned units (Urban sub-total (%))	8102 (35.0)	7640 (31.9)	7163 (28.9)	6876 (26.8)	6710 (25.3)	-5.70	-6.24	-4.01	-2.42
Urban collective-owned units (Urban sub-total)	1499 (6.5)	1291 (5.4)	1122 (4.5)	1000 (3.9)	897 (3.4)	-13.88	-13.09	-10.87	-10.28
Foreign funded units (Urban sub-total (%))*	642 (2.8)	671 (2.8)	758 (3.1)	863 (3.4)	1033 (3.9)	4.52	12.97	13.85	19.70

*Including from Hong Kong, Taiwan and Macao; Statistical Year Book of China: Various issues and own calculation

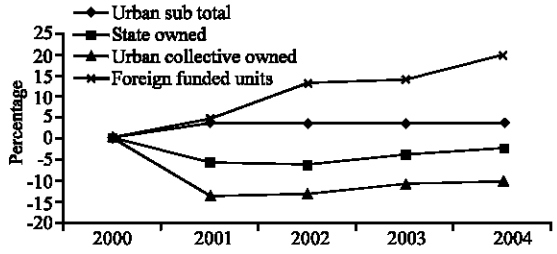

Fig. 1: Urban employment growth in China: different ownership

funded industry is nearly 158 in 1993 comparing to national 100 as shown in Table 8. This is around 128 in 2004, well above the state owned industry's 104 and 61 of collective owned. Although, the index for the foreign funded is decreasing but it is still the highest among all other types of ownerships.

The growth rates of wages enjoy almost, a similar pattern with a peak in 1994. However, one thing we have to take into account that following 2001 the growth rate of wages in the foreign funded industries is decreasing while that of the state owned and urban collective owned industries are increasing.

For a better understanding of FDI impact on wages, we have to look into the sectoral distribution of FDI inflow along with the growth of wages in these sectors. Table 9 here summarizes the FDI inflows during 1997-2004 as well as the wage growths in these sectors during the same. Manufacturing sector receives the highest amount of FDI during this period followed by Real Estate, Electricity-Gas-Water, Agriculture and others. The last two columns of the Table 9 however, shows that the growth of wages is not essentially followed by the share of FDI flows during this period.

The question that goes why some sectors have higher wage growths than the others, while the FDI flows are different with this trend. The fact is that there are differences in skill intensities required in different sectors. The manufacturing sector for example, attracts larger foreign direct investment as China has a huge unskilled population that helps foreign investors to invest in

Table 7: Money wages by ownership comparing to national averages

	Average money wages (Yuan)				Difference from national by		
Years	National	State-owned	Collective owned	Foreign funded	State owned	Collective owned	Foreign funded
1995	5500	5625	3931	8058	125	-1569	2558
1996	6210	6280	4302	9383	70	-1908	3173
1997	6470	6747	4512	10361	277	-1958	3891
1998	7479	7668	5331	11767	189	-2148	4288
1999	8346	8543	5774	12951	197	-2572	4605
2000	9371	9552	6262	14372	181	-3109	5001
2001	10870	11178	6867	16101	308	-4003	5231
2002	12422	12869	7667	17892	447	-4755	5470
2003	14040	14577	8678	19366	537	-5362	5326
2004	16024	16729	9814	20440	705	-6210	4416

Table 8: Index of money wages by ownership and growth of wages

	As percent of national			Growth of wages (previous year = 100)			
Years	State owned	Collective owned	Foreign funded	National	State owned	Collective owned	Foreign funded
1993	104.8	76.9	157.7	-	-	-	-
1994	105.7	71.5	144.0	134.6	135.8	125.2	122.9
1995	102.3	71.5	146.5	121.2	117.3	121.1	123.3
1996	101.1	69.3	151.1	112.9	111.6	109.4	116.4
1997	104.3	69.7	160.1	104.2	107.4	104.9	110.4
1998	102.5	71.3	157.3	115.6	113.6	118.2	113.6
1999	102.4	69.2	155.2	111.6	111.4	108.3	110.1
2000	101.9	66.8	153.4	112.3	111.8	108.5	111.0
2001	102.8	63.2	148.1	116.0	117.0	109.7	112.0
2002	103.6	61.7	144.0	114.3	115.1	111.6	111.1
2003	103.8	61.8	137.9	113.1	113.3	113.2	108.2
2004	104.4	61.2	127.6	114.1	114.8	113.1	105.5

Statistical yearbook of China: Various issues and own calculation

Table 9: Growth of FDI and Wages by Sectors in China (1997-2004)

Sector name	Total flows of FDI: 97-2004 (10000 USD)	Growth of FDI: 1997 = 100	Share of total FDI: 97-2004	Growth of wages: 1997 = 100
Agriculture, forestry, animal husbandry and fishing	578029	821.0	1.8	76.5
Mining	411425	337.5	1.3	146.9
Manufacturing	21890264	678.5	69.3	136.5
Production and distribution of electricity, gas and water	1492626	620.4	4.7	126.0
Construction	741616	415.8	2.3	191.9
Transport, storage and post	891696	438.7	2.8	306.8
Wholesale and retail trade	719457	413.2	2.3	166.7
Financial intermediation*	66741	774.8	0.2	28.8
Real estate	3867341	648.2	12.2	193.6
Culture, sports and entertainment**	72685	964.2	0.2	249.1

*For 2000, 2002, 2003 data are for banking and insurance; **For 2000, 2002, 2003 data are for education, culture, arts, film, radio and television; Statistical yearbook of China: Various issues and own calculation

industries like textile and light manufacturing. The growth of FDI in this sector is high as per the comparative advantage theory but as it uses unskilled labour, the growth of wages is slow. As Wu (2003) notes that FDI in china has a special pattern like developing countries invest more on unskilled labour intensive sectors like agriculture while, the developed countries invest more on the sectors that requires highly skilled labors. Table 10 shows, the FDI inflows by source during 1996-2004. Developed countries contribute nearly 85%, while the developing countries contribute roughly 14% of the total inflows during this period, as shown in Fig. 2. Since, the developed countries possess more technological know how and they invest more in industries, which take skilled labour and the wages should be higher in these industries too. This might be the case why some industries have higher FDI shares but lower wage growths and vice versa.

Finally, we can see the growth of exports of China in the past decade. Figure 3 shows, sectoral growth rate of exports. Manufacturing goods enjoyed a persistently higher growth rate than the primary goods. Furthermore, among manufacturing, growths in machinery goods exports, which are skill intensive are leading well ahead of the textile and light industrial goods. This clearly justifies the skill upgradation theory of globalization and outsourcing we have presented in study of this study and as comparative advantage theory explains that with increasing production and export of goods using skilled

Table 10: FDI by sources (10,000 USD)

Country (region)	1996	1997	1998	1999	2000	2001	2002	2003	2004	Total (1996-2004)
Total	4213516	5238734	4546275	4031871	4071481	4687759	5274286	5350467	6062998	43477387
Asia	3337793	3540641	3133102	2683231	2548209	2961326	3256997	3410169	3761986	28633454
Hong Kong, China	2085160	2155111	1850836	1636305	1549998	1671730	1786093	1770010	1899830	16405073
Japan	369214	439037	340036	297308	291585	434842	419009	505419	545157	3641607
Singapore	224716	260696	340397	264249	217220	214355	233720	205840	200814	2162007
Republic of Korea	150416	222763	180320	127473	148961	215178	272073	448854	624786	2390824
Taiwan, China	348202	334234	291521	259870	229658	297994	397064	337724	311749	2808016
The rest of Asia	160085	128800	129992	98026	110787	127227	149038	142322	179650	1225927
Africa	1202	8237	15876	19606	28771	32977	56462	61776	77568	302475
Europe	303449	455961	430933	479713	476539	448398	404891	427197	479830	3906911
Latin America	65097	198152	456213	320447	461658	630891	754979	690657	904353	4482447
North America	65097	198152	432943	461608	478579	509685	649032	516135	497759	3808990
Oceanic and Pacific Islands	29830	58619	53369	50920	69403	101478	141722	173119	197437	875897
Developing countries*	226384	335189	602081	438079	601216	791095	960479	894755	116 1571	601 0849
Developed countries**	3576084	4124573	3920355	3577446	3461943	3893660	4303604	4384298	475 7362	3599 9325

Statistical yearbook of China: Various issues and own calculation; *The rest of Asia, Africa and Latin America; **Hong Kong, Japan, Singapore, Korea, Taiwan, Europe, North America and Oceanic-pacific islands

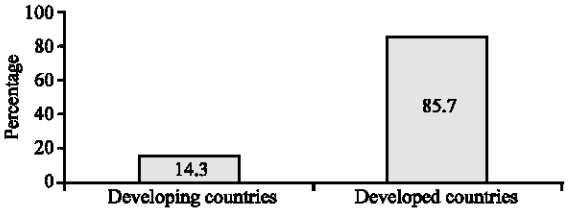

Fig. 2: Sources of FDI during 1996-2004

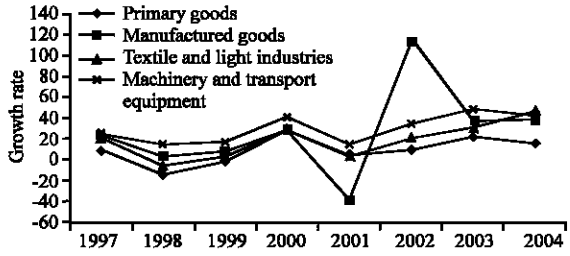

Fig. 3: Growth of exports in China (1996-2004). Data source: statistical year book of China 2006; calculation and drawing by the author

(unskilled) labor intensively, it is obvious that the skilled (unskilled) labor will be benefited mostly in terms of increasing wages. China's hankering for FDI in quest for better technology and its spill over therefore, might be explained as one of the factor acting behind its increasing inequality.

RESULTS AND DISCUSSION

It is evident from this study that foreign funded industries have higher wages than the state owned and urban collective owned industries in China. This implies that in the urban collective owned and state owned industries labour productivity might have been low, which results lower wages and thus, aggravating wage inequality. To address this issue Chinese government should initiate some sorts of reforms in the labour market. Skill up gradation through better training, efficient management, employment through competitive hiring and firing and others reforms could help in this regard. Secondly, China has comparative advantage in unskilled labor intensive industries. If China could take policies to attract FDI in these industries it would be the unskilled labour wages to be increased in larger proportion. This could redirect the ongoing increasing inequality in a favorable fashion. Thirdly, there might have the option of tax and transfer to redistribute income from higher income group to the lower income group. This could also help to improve income equality in the long.

Since the 1970s, China has been emphasizing to attract FDI inflow to boost its economic development. A pro-market reform in the 1990s is shown to be able to make foreign investors to think China as a safe harbor for their investment. Today, China holds second place in the world followed by USA in attracting FDI. A large number of multinationals are working there nowadays. But as the multinationals are usually well equipped with better technology and efficient management it also leads to a growing wage disparity among the Chinese workers. The last decade saw an increasing money wage gap by the foreign funded industries over the state owned and urban collective owned industries. This is particularly evident for the foreign funded industry that the higher the industry uses sophisticated technology the higher is the skilled labor it requires, consequently the higher is wages, aggravating wage inequality in Chinese society. In the unskilled labor, intensive foreign funded industries wages are still higher than the national average, but the margin is narrow one. The government of China therefore, can redirect its policy to attract FDI in unskilled labour intensive industries, in which she has comparative

advantage too along with necessary labor reforms and fiscal policies to address the inequality issue in long run.

CONCLUSION

The study thus, concludes for labor market reforms in China: to improve labor's skill and productivity in state owned and urban collective owned industries. Furthermore, China being abundant with huge unskilled labor has comparative advantage in unskilled labor intensive industries.

SUGGESTIONS

This study thus, also suggests taking policies to attract FDI in these industries so that unskilled labor wages to be pushed up to redirect the ongoing increasing inequality.

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