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To cite this article: Yanan LiYANAN LI, Ravi KanburRAVI KANBUR & Carl LinCARL LIN (2019) Minimum Wage Competition between Local Governments in China, The Journal of Development Studies, 55:12, 2479-2494, DOI: [10.1080/00220388.2018.1536263](https://doi.org/10.1080/00220388.2018.1536263)

To link to this article: <https://doi.org/10.1080/00220388.2018.1536263>



Published online: 30 Oct 2018.



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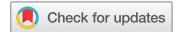
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Minimum Wage Competition between Local Governments in China

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(Original version submitted April 2017; final version accepted September 2018)

ABSTRACT *The theory of fiscal and regulatory competition between jurisdictions is more advanced than its empirical testing. This is particularly true of labour regulation in general, and minimum wage regulation in particular, and especially so for developing countries. This paper utilises the spatial lag methodology to study city-level strategic interactions in setting and enforcing minimum wage standards during 2004–2012 in China. We manually collect a panel data set of city-level minimum wage standards from China's government websites. This analysis finds strong evidence of spatial interdependence in minimum wage standards and enforcement among main cities in China. If other cities decrease minimum wage standards by 1 RMB, the host city will decrease its standard by about 0.7–3.2 RMB. If the violation rate in other cities increases by 1 per cent, the host city will respond by an increase of roughly 0.4–1.0 percentage points. The results are robust to using three estimation methods, Maximum Likelihood, IV/GMM, and a dynamic panel data model. Our findings of strategic interactions suggest the need for policy coordination in labour regulation in China.*

1. Introduction

Strategic interactions of fiscal policies among governments have been well discussed in both theoretical and empirical studies. Early examples of theory papers on tax competition include Kanbur and Keen (1993), Edwards and Keen (1996), and Wilson and Wildasin (2004).¹ Compared to tax competition and environmental policy competition, however, jurisdictional interactions of labour standards and regulatory policies have not been studied as intensively (some examples include Davies & Vadlamannati, 2013; Duanmu, 2014).

Conventional wisdom is that there is a potential ‘race to the bottom’ in labour standards across countries. Governments might undercut each other’s labour standards to attract foreign capital (for example, Chau & Kanbur, 2006; Davies & Vadlamannati, 2013; Olney, 2013). On the other hand, strategic interactions among jurisdictions could also lead to a ‘race to the top’ of labour standards, for example, in the case that labour becomes a scarce resource. Regardless of whether it is a race to the bottom or to the top, the key idea is that policies in one country might be influenced by those in others. While the existing literature has provided evidence on between-country interactions in labour standards, there is so far little evidence on within-country competition, especially in developing countries. Given the importance of this issue, this paper fills the gap by providing the evidence for strategic interactions on minimum wage standards in China.

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This paper focuses on minimum wages as a leading example of labour standards for the following reasons. First, minimum wage standards directly reflect the overall level of labour standards in the local labour market. For instance, an increase in minimum wages leads to a rightward shift of the whole wage distribution (Neumark, 2004). Second, the frequent adjustments of minimum wage standards in recent years make China an ideal policy setting to identify interjurisdictional competition within a country. Before the year 2004, a minimum wage standard was close to nonexistent, with low statutory levels and weak enforcement of the laws. From the mid-2000s onwards, however, rising concerns on inequality led to considerable strengthening of regulation and enforcement of minimum wage standards. As a result, there have been large time and spatial variations in both minimum wage standards and enforcement since 2004. Third, the decision-making system of minimum wage standards and the enforcement is relatively decentralised in China, which is also critical to the study of jurisdictional competition. Therefore, we use minimum wages as an example to study labour standard competition.

This paper relies on a Spatial Lag framework combined with exogenous covariates to identify the spatial interdependence in setting up and enforcing minimum wage standards in China. In the analysis of minimum wage standards, we collect a panel data set of city-level minimum wage standards from China's government websites during 2004–2012. To estimate the magnitude of spatial interdependence, we first estimate a spatial static panel data model using both Maximum Likelihood method and Instrumental Variables (IV/GMM) method, then estimate a dynamic panel data model using Arellano-Bond GMM estimator. The analysis finds strong evidence of spatial correlation in minimum wage standards. If other cities increase (or decrease) minimum wage standards by 1 RMB, the host city will increase (or decrease) its standard by about 0.7–3.2 RMB.

Then we conduct a parallel analysis of strategic interactions on minimum wage enforcement. The literature on fiscal competition has found that enforcement policies are used as instruments for fiscal competition, when competition in tax rates are banned (Cremer & Gahvari, 2000). For instance, Ronconi (2012) finds that governments react to the competitive pressures produced by FDI inflow by turning a blind eye to noncompliance of labour laws. Bhorat, Kanbur, and Mayet (2012) is an example of the recent literature documenting non-compliance with minimum wage regulation in developing countries. Despite data limitations, the current paper makes the first attempt to assess competition on the enforcement of minimum wage standards. We find that if the violation rate in other cities increases by 1 per cent, the host city will respond by an increase of roughly 0.3 percentage points.

The rest of the paper is organised as follows. Section 2 introduces the institutional background of minimum wage setting in China. Section 3 describes data. Section 4 sets the empirical model and discusses identification strategies. Section 5 presents the main results, followed by robustness checks in Section 6. Section 7 concludes by putting our results in the context of the broader literature and looks ahead to areas for further research.

2. Institutional background

2.1. Minimum wage setting and enforcement in China

Minimum wage regulations have existed in China since the 1990s, but only with low levels of standards and weak enforcement. Things did not change until the early 2000s, when rising income inequality became a national concern. In 2004, the Ministry of Labor and Social Security issued the 'Minimum Wage Regulations' law, stipulating that provinces should adjust minimum wage levels at least every two years to fit local living standards. Then the next decade saw frequent upward minimum wage adjustments along with improved compliance. Table 1 shows that around 60 per cent of cities adjusted minimum wage standards each year during 2004–2012 (except for 2009). While real minimum wage rates almost doubled during 2004–2009, the average noncompliance rate decreased from 8.9 to 7.6 per cent.

Table 1. Trend of minimum wage standards, 2004–2012

Year	Min wage	Growth of min wage (%)	% of jurisdictions adjusting min wage	Violation rate	Kaitz ratio (min wage/median wage)
2004	366	9.3%	66%	8.9%	37%
2005	395	7.9%	35%	8.5%	35%
2006	459	16.2%	88%	9.0%	37%
2007	487	6.1%	62%	10.0%	40%
2008	509	4.4%	64%	9.8%	41%
2009	512	0.6%	0%	7.6%	38%
2010	616	20.4%	99%		
2011	682	10.7%	78%		
2012	745	9.2%	68%		
Total	493	8.9%	58%	9.2%	38%

Notes: Minimum wages are deflated by the provincial level CPI, using 2002 CPI as the base. City-level violation rate is calculated as the fraction of workers paid below local minimum wages.

The decision process of minimum wage adjustment varies by provinces. In some provinces, prefecture-cities are actively involved in adjusting minimum wage standards.² For instance, the city Chengdu in Sichuan province and the city Shenzhen in Guangdong province could set their own minimum wage standards, according to our survey with local practitioners. In other provinces, cities and counties are sorted into several tiers based on their economic development levels (usually four). The provincial government then consults with labour unions and sets the floors of minimum wage standards for each group of cities. The wiggle room left for city governments in deciding the final minimum wage standards is articulated in two ways: which group to be grouped into; and whether (and of what magnitude) it is possible to further adjust the standard upward given the floor. For instance, the city of Haimen in Jiangsu province was in tier 2 area before 2007, but in tier 1 since 2008. Therefore, cities in this second type of provinces also have some degree of flexibility in the final decision of minimum wage standards. Overall, cities all have some flexibility in setting up minimum wage standards, which is evidenced by large within province variations of minimum wage standards.

When it comes to enforcing minimum wage laws, the ‘Minimum Wage Regulation’ law specifies that governments at the county level and above are in charge of the enforcement in local areas. Therefore, prefecture-level cities, which stand one level above counties, will have full control over minimum wage enforcement in their cities. And this authority makes it possible for cities to compete against each other in the enforcement of minimum wage laws.

2.2. Motivation of local leaders to compete on minimum wages

Leaders of city governments have at least the following three motivations to compete against each other on minimum wage standards and enforcement. While they are all plausible and have been documented in the literature, this paper does not discriminate one source from another.

The first incentive for interjurisdictional competition on minimum wages is competing for capital, which could lead to a race to the bottom of minimum wages. If we assume capital flows to places with lower labour cost, then more stringent labour standards (for example, minimum wages, labour rights) in local areas compared to other areas would reduce the attractiveness of local environments for firms. Therefore, local leaders might undercut each other’s labour standards and employment protections to attract foreign (and domestic) capital (Chau & Kanbur, 2006; Davies & Vadlamannati, 2013; Olney, 2013).

The second incentive for interjurisdictional competition on minimum wages is competing for labour which, to the opposite of the first incentive, might lead to a race to the top of minimum wages. It has been argued that China has passed the Lewis turning point, and the era of surplus labour

is over (Zhang, Yang, & Wang, 2011). Moreover, because a tightening labour market in an era of high economic growth gives workers stronger wage bargaining power, the last decade has seen rising labour costs across the country. Therefore, city governments might engage in the competition for labour.

Last but not least, city leaders might strategically set and enforce minimum wage standards driven by promotion incentives. Promotion of local leaders in China is decided by their upper-level governments, based on performance comparison across jurisdictions. It has been shown that such a promotion scheme leads to tournament competition among local leaders in multiple aspects, such as in investment (Yu, Zhou, & Zhu, 2016) and coal mine safety (Shi & Xi, 2018). In a similar vein, city leaders might be motivated to engage in tournament competition in minimum wage standards, if labour standards are important components of the performance evaluation for local government leaders. This motivation is likely in particular because China is faced with rising inequality and minimum wage standards have been used as an important tool to curb the rising inequality.

3. Data

We construct a panel data set from several sources. City level minimum wage standards in 2004–2012 are manually collected from local government websites (through searching ‘Baidu’, a Chinese version of Google).³ City characteristics and boundary shapefiles are compiled from China Data Online (see [Table A1](#) in the Appendix for descriptive statistics of city characteristics).

The final data set for the analysis of minimum wage standards includes 252 prefecture-level cities in 25 provincial-level administrative units as opposed to all 294 prefecture-level cities in 34 provincial-level units of China. This subsample property will not bias our estimations for the following three reasons. First, the final data set is not derived by a non-random selection process; rather it is a result of combining data sets from different sources.⁴ Second, results are not driven by individual provinces, as the estimates are not sensitive to dropping any individual provinces ([Section 6.1](#) will give more details). Third, we also run two-sample t-tests for each economic variable in the omitted sample and the included sample. None of the mean differences is statistically significant.⁵

As discussed earlier, the frequent upward minimum wage adjustments provide a good source of identification for interjurisdictional dependence. [Table 1](#) shows that about 58 per cent of prefecture-level cities adjust minimum wages in each year during 2004–2012. The only exception is 2009, when no provinces adjusted minimum wages due to the financial crisis. 2006, 2010, and 2011 all witnessed a two-digit increase of minimum wages compared to the previous years.

In the second main analysis, ‘race on minimum wage enforcement’, we proxy the degree of enforcement by noncompliance rates of minimum wage standards in the city, which is derived from the 2002–2009 Urban Household Survey (UHS). UHS is a continuous, large-scale, socio-economic survey conducted by the National Bureau of Statistics of China to study the conditions and living standards of urban households. Survey subjects include local urban households, non-local urban households who have lived in the city for at least six months, and some rural-urban migrant households. The survey covers 16 representative provinces, but our sample only keeps the cities that were surveyed throughout all years during 2004–2009. As a result, the final data set in the analysis includes only 66 prefecture-level cities distributed in nine provinces. Again, the relatively small sample size should not bias our estimates of the spillover effect of minimum wage enforcement, given the randomness of UHS sampling and sample selection process. As a matter of fact, the economic characteristics are by and large quite similar between these 66 prefecture-level cities and those dropped from the analysis.⁶

To calculate city specific noncompliance rates, we take advantage of the employment and wage information from the questionnaire.⁷ Specifically, violation rates of minimum wage standards are defined as the number of workers paid below local minimum wage standards divided by the employment size in the city. As [Table 1](#) shows, on average, 9.2 per cent of workers are underpaid during the study period. An important determinant of noncompliance rates is the Kaitz ratio, namely

the ratio of minimum wage standards and median wages. Cities with a higher Kaitz ratio might be harder to fully enforce minimum wage standards, and hence have a higher violation rate than cities with a lower Kaitz ratios. Table 1 shows that the level of minimum wage standards is on average 38 per cent of the median wage in a city.

4. Empirical specification

This paper uses a spatial lag framework to estimate city-level strategic interactions in setting and enforcing minimum wage standards.⁸ For each analysis, we first estimate a spatial static panel data model using both Maximum Likelihood method⁹ and Instrumental Variables (IV/GMM) method, then we estimate a dynamic panel data model using the Arellano-Bond GMM estimator.

4.1. Race on minimum wage standards

To test whether minimum wage standards in the host city depend on minimum wage standards in other cities, we estimate the following Spatial Autoregression Regression (SAR) model,

$$MW_{i,t} = \beta_0 + \rho \sum_{j \neq i} \omega_{j,i} MW_{j,t} + \beta X_{i,t-1} + \eta_i + \delta_t + \varepsilon_{i,t} \tag{1}$$

where $MW_{i,t}$ is the minimum wage standard in city i in year t ; $\sum_{j \neq i} \omega_{j,i} MW_{j,t}$ is the Spatial Lag, the weighted average of minimum wage standards in other jurisdictional areas. ρ captures the spatial dependence of minimum wages. $X_{i,t-1}$ is a vector of city-level economic characteristics, including GDP, per capita GDP, industry share in total GDP, labour force participation rate, the proportion of employees in the primary industry, student enrolment in secondary schools, student enrolment in primary schools, the number of large-scale enterprises, and the number of beds in hospitals.¹⁰ We take a one-year lag of the covariate vector to enhance the case for exogeneity.¹¹ All values such as GDP and minimum wages are deflated by the provincial level Consumer Price Index, with 2002 as the base year. η_i controls for city fixed effects; δ_t controls for year fixed effects. For descriptive statistics, see Table A1 in the Appendix.

The key independent variable, spatial lag, is constructed using two different weighting matrices ($\omega_{j,i}$) in the main results, and four additional weighting matrices in the robustness checks. First, we use a contiguity matrix, where a city’s neighbours are defined as prefecture cities that share borders with it. The weighting matrix is normalised so that the row sum equals to unity. If the host city i has n_i neighbours, then the weight that city i puts on city j is defined as,

$$\omega_{j,i} = \begin{cases} \frac{1}{n_i}, & \text{if city } j \text{ is one of the } n_i \text{ neighbors of city } i's, \\ 0, & \text{otherwise} \end{cases} \tag{W1}$$

Second, we use an inverse distance-based weighting matrix, assuming that closer cities have stronger impacts on city i than cities farther away. The neighbourhood-inverse distance matrix is as follows.

$$\omega_{j,i} = \frac{1}{d_{ij}}, \text{ where } d_{ij} \text{ is the distance between the centroids of city } i \text{ and city } j \tag{W2}$$

The main econometric challenge to identify the magnitude of the spatial interdependence is the reflection problem (Manski, 1993). Because $MW_{i,t}$ and $MW_{j \neq i,t}$ are simultaneously determined, the spatial lag term is not orthogonal to the error term. As a result, OLS does not give consistent estimates. To deal with this endogeneity, the most common methods include Maximum Likelihood method and Instrumental Variables (IV/GMM) method (Belotti, Hughes, & Piano Mortari 2016;

Brueckner, 2003; Davies & Vadlamannati, 2013; Shi & Xi, 2018). We use both methods to derive the estimates and then compare the consistency of the results. In the spatial IV method, we instrument the spatial lag with $\sum_{j \neq i} \omega_{j,i} X_{jt-1}$, the weighted average of other cities' exogenous variables. The identification assumption is that city j 's exogenous variables only affect its own minimum wage standards but do not directly impact those in city i .

In addition to estimating a static spatial lag model in Equation (1), we add time-lagged minimum wage standards into the right-hand side of the model because minimum wage standards in the current year might also depend on minimum wages in the previous year. By doing so, the model becomes a dynamic panel model and fixed effect estimators are no longer consistent. To address this issue and potential endogeneity concerns, we follow Olney (2013) and estimate the dynamic model using Arellano–Bond GMM estimator (Arellano & Bond, 1991). This method takes the first difference of the model and instruments the right-hand side differenced terms with all their lagged levels.¹² We also include additional instruments, the lagged levels of weighted averages of other cities' exogenous variables, $\sum_{j \neq i} \omega_{j,i} X_{jt-1}$, which were used as instruments in estimating Equation (1). The estimation equation is as follows:

$$\Delta MW_{i,t} = \alpha \cdot \Delta MW_{i,t-1} + \rho \cdot \Delta \sum_{j \neq i} \omega_{j,i} MW_{j,t} + \beta \cdot \Delta X_{i,t-1} + \Delta \delta_t + \Delta \varepsilon_{i,t} \tag{2}$$

where $\Delta MW_{i,t}$ is the change of minimum wage standards in city i from year $t-1$ to year t ; $\Delta \sum_{j \neq i} \omega_{j,i} MW_{j,t}$ is the change of the spatially lagged minimum wage standards in city i from year $t-1$ to year t . This method identifies a causal impact of other cities' minimum wage policies on the host city's policy.

4.2. Race on minimum wage enforcement

To study interjurisdictional interactions on enforcement, we modify Equation (1) by changing $MW_{i,t}$ to $E_{i,t}$, where $E_{i,t}$ is the enforcement level in city i year t . The model is as follows,

$$E_{i,t} = \beta_0 + \rho \sum_{j \neq i} \omega_{j,i} E_{j,t} + \beta X_{i,t-1} + \gamma Kaitz_{i,t} + \eta_i + \delta_t + \varepsilon_{i,t} \tag{3}$$

where $Kaitz_{i,t}$ indicates the ratio of minimum wage to median wage calculated for each city. This is the only additional covariate compared to Equation (1); we add it because cities with higher minimum wage standards tend to have lower enforcement and higher violations. Enforcement intensity could ideally be measured by the amount of resources (for example, inspectors) that the local government invests to regulate minimum wage laws, but such data are lacking. Instead, because stronger enforcement intensity is associated with lower minimum wage noncompliance (Bhorat et al., 2012), we proxy enforcement by the headcount ratio of minimum wage violations: the number of workers receiving below minimum wages divided by the total number of working population. Again, Equation (3) is estimated using both MLE and IV methods, using the same instruments as when estimating Equation (1).

Because the enforcement analysis uses household survey data to compute violation rates, and the household survey is conducted in a randomly selected subsample of cities in the country, we end up having many 'islands' and other cities with few contiguous neighbours. Therefore, we only use the inverse distance weighting matrix to construct spatial lags. The construction of the matrix is the same as Equation (W2).

Again, we introduce a time-lagged enforcement variable into the righthand side of Equation (3) and estimate the dynamic panel model using Arellano-Bond estimator. The first differenced model is as follows,

$$\Delta E_{i,t} = \alpha \cdot \Delta E_{i,t-1} + \rho \cdot \Delta \sum_{j \neq i} \omega_{j,i} E_{j,t} + \beta \cdot \Delta X_{i,t-1} + \gamma \cdot \Delta Kaitz_{i,t} + \Delta \delta_t + \Delta \varepsilon_{i,t} \quad (4)$$

where $\Delta E_{i,t}$ is the change of minimum wage violation rates in city i . This model identifies a causal impact of other cities' enforcement levels on the host city's enforcement.

5. Main results

5.1. Race on minimum wage standards

Table 2 presents estimation results for jurisdictional interdependence on minimum wage standards using three different estimation methods and two weighting matrices. Equations (1) and (2) both use MLE method, with Equation (1) using the contiguity matrix (Equation W1) and Equation (2) using

Table 2. Results of the analysis of minimum wage standards, 2004–2012

	MLE		IV/GMM		Arellano-Bond GMM	
	(1)	(2)	(3)	(4)	(5)	(6)
	Contiguous	Distance	Contiguous	Distance	Contiguous	Distance
Spatial lag of minimum wages	0.72*** (0.02)	0.97*** (0.00)	0.99*** (0.11)	2.33*** (0.18)	0.98*** (0.04)	3.23*** (0.17)
L. min wage					0.06** (0.03)	0.05 (0.03)
GDP (log)	5.03 (8.45)	-8.65 (10.90)	12.73* (7.31)	-0.80 (8.02)	20.29 (26.01)	-33.80 (26.46)
per capita GDP (log)	-8.90 (6.36)	-4.42 (8.46)	-12.99** (5.55)	-9.42 (6.36)	-37.47** (16.55)	-33.05* (19.49)
Labour participation Rate (%)	0.79** (0.34)	1.16*** (0.40)	0.77*** (0.30)	1.48*** (0.37)	2.64** (1.07)	5.22*** (1.23)
Industry share (%)	-0.39 (0.27)	-0.61* (0.35)	-0.21 (0.20)	-0.23 (0.22)	-0.09 (0.41)	0.51 (0.53)
# of enterprises (1000)	5.55* (2.99)	8.98** (3.85)	3.27 (3.93)	8.56** (3.45)	-1.84 (2.95)	1.61 (3.54)
# of beds in hospitals	-13.49 (10.28)	-25.68** (11.71)	-5.46 (8.75)	-10.15 (9.26)	-8.85 (26.11)	34.34 (25.18)
Stud enrol in secondary school	-1.73*** (0.50)	-1.73*** (0.54)	-1.74*** (0.51)	-1.67*** (0.47)	-0.72 (1.10)	-0.29 (1.38)
% of secondary employment (%)	-0.33 (0.22)	-0.53* (0.28)	-0.14 (0.18)	-0.20 (0.21)	-0.94** (0.46)	-1.17* (0.60)
Stud enrol in primary school	0.95 (0.95)	2.51** (1.14)	0.02 (0.73)	1.48* (0.79)	-0.59 (1.58)	-2.67 (1.93)
City FE	Y	Y	Y	Y	Y	Y
Year FE	Y	Y	Y	Y	Y	Y
Observations	2016	2016	2016	2016	1512	1512
R2			0.96	0.94		
Kleibergen-Paap rk Wald F stat			66.21	305.17		
Hansen J statistic (p-val)			0.750	0.245	0.822	0.773
AR (2) p-value					0.998	0.210

Notes: Equations (1) and (2) show MLE estimation results. Equation (1) uses simple contiguity matrix (Equation W1); column 2 uses inverse distance matrix (Equation W2). Likewise, Equations (3) and (4) show IV/GMM estimation results; Equations (5) and (6) use the Arellano-Bond difference GMM estimation method, using all lagged terms as instruments. Results also hold using Arellano-Bond system GMM method. Control variables are taken a one-year lag. Robust standard errors in parentheses are clustered at the city level. Year 2009 is dropped from all analyses, because no minimum wage adjustments occurred in any city during the year. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

the inverse distance matrix (Equation W2). Likewise, Equations (3) and (4) show IV/GMM estimation results; Equations (5) and (6) use the Arellano-Bond difference GMM estimation method, using all lagged terms as instruments.

Overall, these Equations give consistent results that other cities' minimum wage standards have a positive effect on the host city's minimum wage standards. The magnitude of spatial dependence ranges between 0.7 and 3.2. In other words, if other cities increase their minimum wages by 1 RMB, the host city will increase its minimum wage standard by 0.7–3.2 RMB. This estimated magnitude of spatial dependence is comparable to that by other studies using similar methods. For instance, Davies and Vadlamannati (2013) use the IV/GMM method to estimate spatial interactions in labour standards across countries and find point estimates between 0.2 and 2. Olney (2013) finds the point estimate of intergovernmental dependence in employment protection is between 0.18 and 0.44 when using Arellano-Bond GMM method, but as large as between 1.6 and 2.9 when using the IV method.

Across the models, a few control variables have statistically significant point estimates. First, cities with higher labour force participation have higher minimum wages. Second, a higher enrolment rate of primary school students is associated with higher minimum wages, but a higher enrolment rate of secondary school students is associated with lower minimum wages. Third, a higher number of large-scale enterprises is associated with higher minimum wages, which could be explained by higher demand for labour. In addition, the estimates from Equation (2) show positive coefficients on the lagged minimum wage term, suggesting that minimum wage standards might be persistent over time.

5.2. Race on enforcement

Table 3 presents estimation results for jurisdictional interdependence on minimum wage enforcement using different estimation methods and the inverse distance weighting matrix. Enforcement is proxied by the headcount ratio of minimum wage violation. Equation (1) uses MLE method; Equation (2) uses IV/GMM estimation method; and Equation (3) uses the Arellano-Bond difference GMM estimation method.

The results consistently show evidence of a race on the enforcement of minimum wage standards, with the point estimate ranging in [0.38, 0.85] across three models. In other words, if the weighted violation rate in other cities increases by 1 per cent, the violation rate in the host city will increase by 0.38–0.85 percentage points. The insignificant coefficient on the lagged violation rate in the dynamic model (in column 3 of Table 3) suggests that the strictness of enforcement is not persistent over time. The share of secondary industry GDP in total GDP and the share of secondary industry employment in total employment are both positively associated with the violation rates of the minimum wage standards. In addition, the positive coefficient of Kaitz ratio indicates that a higher minimum-to-median wage ratio results in a higher violation rate of the minimum wage law in the city.

6. Robustness checks

6.1. Robustness to sample changes

There might be potential concerns that the evidence of spatial interdependence in minimum wage standards is driven by a subset of the provinces. To address this concern, we examine the sensitivity of point estimates to the exclusion of individual provinces. Results are plotted in Figure 1. For instance, the first point shows that the magnitude of spatial interdependence is 2.35 after excluding Beijing; the second point shows that the magnitude of spatial interdependence is about 2.4 after excluding Tianjin; and so on. Overall, the point estimates are not sensitive to excluding a particular province, with the magnitudes in the range [2.1, 2.5]. Note that while these estimates are derived using the IV/GMM method, the MLE and Arellano-Bond estimation methods also give robust evidence of spatial interdependence.

Table 3. Results of the analysis of minimum wage enforcement, 2004–2009

	MLE	IV/GMM	Arellano-Bond GMM
	(1)	(2)	(3)
Spatial lag (Violation Rate)	0.38** (0.16)	0.60* (0.36)	0.85* (0.48)
L. Violation Rate			-0.07 (0.11)
GDP (log)	1.78 (1.93)	1.99 (1.67)	7.60 (14.61)
per capita GDP (log)	-0.35 (1.35)	-0.31 (1.45)	-3.93 (6.69)
Labour participation Rate (%)	-0.12* (0.06)	-0.13* (0.07)	-0.03 (0.44)
Industry share (%)	0.15*** (0.06)	0.14*** (0.05)	0.09 (0.16)
# of enterprises (1000)	0.02 (0.39)	0.07 (0.45)	0.37 (1.57)
# of beds in hospitals	0.29 (2.92)	-0.08 (2.99)	-3.00 (7.95)
Student enrol in secondary school	-0.32 (0.30)	-0.34 (0.28)	-0.08 (2.29)
% of secondary employment	0.10* (0.05)	0.11** (0.05)	0.11 (0.18)
Student enrolment in primary school	-0.34 (0.24)	-0.34 (0.21)	0.13 (0.82)
Kaitz ratio (%)	0.42*** (0.05)	0.40*** (0.05)	0.36*** (0.14)
City FE	Y	Y	Y
Year FE	Y	Y	Y
Observations	396	396	264
R2		0.48	
Kleibergen-Paap rk Wald F stat		63.56	
Hansen J P-value		0.860	0.662
AR (2) p-value			0.360

Notes: Equation 1 shows MLE estimation results. Equation 2 shows IV/GMM estimation results; and Equation 3 uses Arellano-Bond difference GMM estimation method. All models use inverse distance weighting matrices to construct the spatial lag term. Control variables are taken a one-year lag. Robust standard errors in parentheses are clustered at the city level. ***p < 0.01, **p < 0.05, *p < 0.1.

Likewise, there might be potential concerns that the evidence of spatial interdependence in the minimum wage enforcement is driven by only a subset of the sample. We conduct a similar subsample analysis and show the results in [Figure 2](#) which is parallel to [Figure 1](#). It suggests that the evidence of spatial interdependence in minimum wage enforcement is robust to excluding any individual provinces, with the estimated coefficients ranging between 0.2 and 1.1.

6.2. Robustness to alternative weighting matrices

While the previous estimates in the main results are derived using distance-based weighting matrices, economic distance might also be important. A city might be more likely to reference minimum wage standards in cities that have similar economic development levels rather than cities that do not. Economic characteristics weights are common in the literature, for example, [Davies and Vadlamannati \(2013\)](#) and [Olney \(2013\)](#). Therefore, we construct four economic characteristics-based weighting matrices and re-estimate the model.

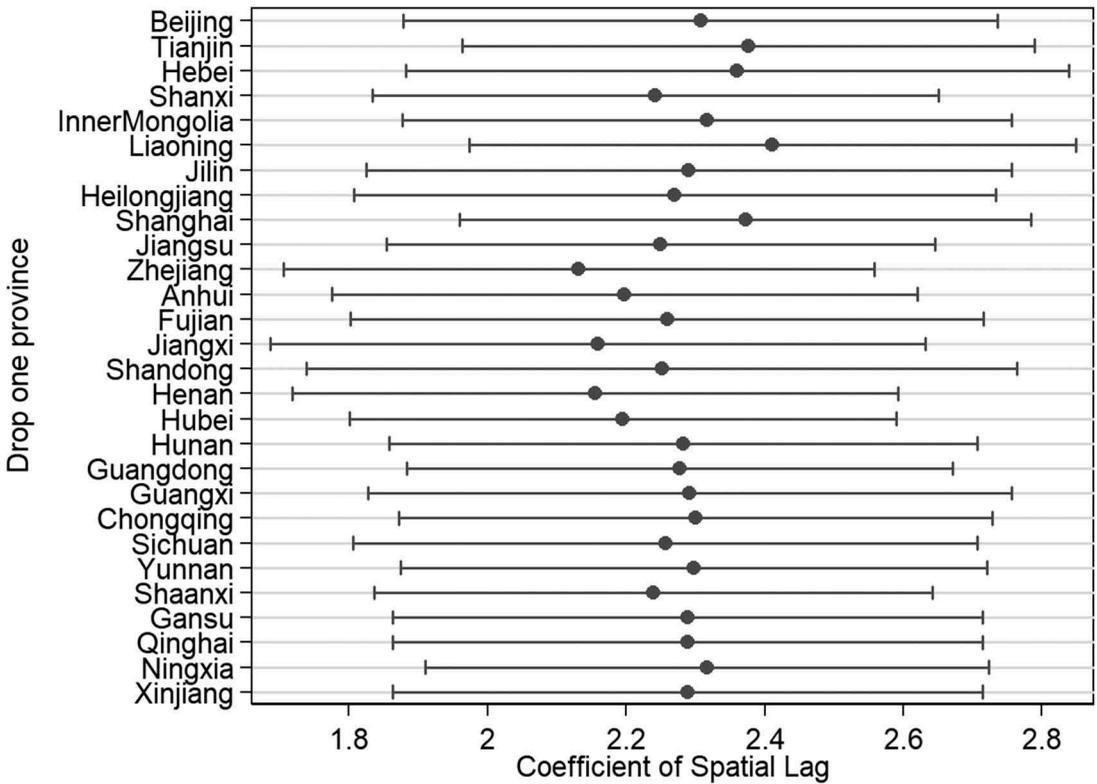


Figure 1. Robustness of minimum wage competition to excluding a province.

Notes: Each point estimate is the coefficient of the spatial lag of minimum wages, using IV/GMM estimation method and inverse distance weighting matrix, after excluding the labelled province.

Economic characteristics are all taken from the year 2003, one year before the first year of our analysis, so that the weighting matrix is arguably exogenous. In the case of GDP weighting matrix, the weight is calculated by $\omega_{j,i} = \frac{1}{|\ln GDP_{j,t=2003} - \ln GDP_{i,t=2003}|}$ and standardised to row sum equal to one. Likewise, we replace log GDP by three other economic indicators, labour force participation rate, the number of enterprises, and per capita GDP, to construct three other weighting matrices. Lastly, we multiply the inverse distance weighting matrix and the per capita GDP weighting matrix to construct a new matrix, which will then incorporate both geographical and economic distance. Table 4 presents estimation results using these weighting matrices, each with three estimation methods. Again, the results are robust to the choice of weighting matrices. All models give consistent results of spatial dependence in minimum wage standards. The magnitudes of estimation are also comparable to those in the main results.

Similarly, we construct economic characteristics-based weighting matrices and re-estimate the race on the enforcement models. Table 5 shows that MLE and Arellano-Bond estimation methods yield statistically significant results, whereas IV/GMM method does not. The magnitudes of the estimates are comparable to those in the main results (Table 2). Overall, the finding of a race on enforcement is robust to using economic characteristics-based weighting matrices.

7. Conclusion

The theory of fiscal and regulatory competition between jurisdictions is more advanced than its empirical testing. This is particularly true of labour regulation in general, and minimum wage regulations in particular,

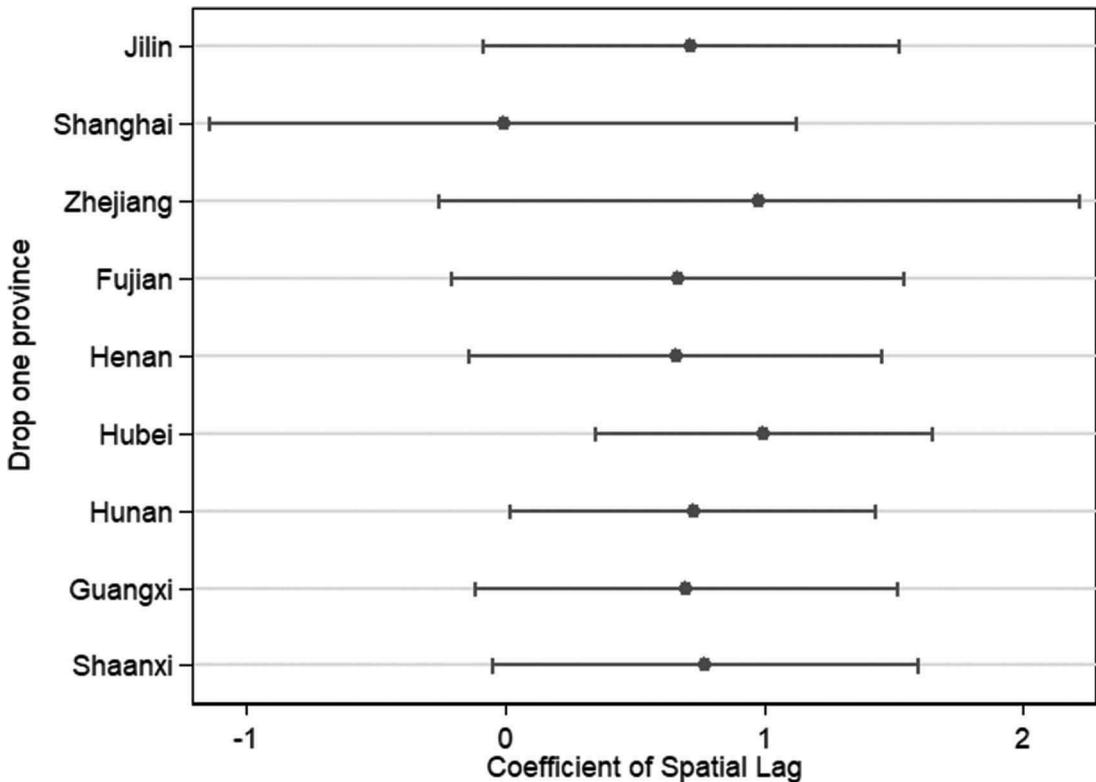


Figure 2. Robustness of minimum wage enforcement competition to excluding a province.

Notes: Each point estimate is the coefficient of the spatial lag of minimum wage violation rates, using IV/GMM estimation method and inverse distance weighting matrix, after excluding the labelled province.

and especially so for developing countries. Olney (2013) finds evidence of a race to the bottom in employment protection among OECD countries, with a reaction coefficient of 1.0–2.8. Davies and Vadlamannati (2013) find labour rights in one country are positively correlated with those elsewhere, that is, a cut in labour rights in other countries reduces labour rights in the host country, with the reaction coefficient about 0.55–0.88. They also argue that international competition lies more in enforcement than in labour laws.

This paper focuses on within-country competition on labour standards, and takes up the case of China, which introduced a vigorous minimum wage regime from the mid-2000s onwards. The analysis utilises the spatial lag framework and three estimation methods (including maximum likelihood estimation, IV/GMM method, and Arellano-Bond GMM method) to study city-level strategic interactions in setting and enforcing minimum wage standards during 2004–2012 in China. We manually collect a panel data set of city-level minimum wage standards from China's government websites. The analysis finds strong evidence of spatial correlation in minimum wage standards and enforcement among main cities in China. If other cities decrease minimum wage standards by 1 RMB, the host city will decrease its standard by about 0.7–3.2 RMB. If the violation rate in other cities increases by 1 per cent, the host city will respond by an increase of 0.4–1.0 percentage points.

The Chinese government has expanded minimum wage intervention greatly, in response to concerns about rising inequality. Our results show that there is significant interjurisdictional competition on the level of the minimum wage and in the enforcement among local governments. Such competition could be wasteful, and lead to a race to the bottom, undermining the government's objectives. The interactions identified in this paper thus suggest the need for policy coordination on labour regulation in China.

Our analysis has broader significance given the resurgence of interest in minimum wages in developing countries as an instrument for addressing rising inequality. Borat, Kanbur, and Stanwix (2017) provide a

Table 4. Robustness of minimum wage competition to alternative weighting matrices

	2003 GDP (log)	Labour force part. rate	# of enterprise	Distance + (log) per cap GDP
	(1)	(2)	(3)	(4)
<i>Panel A: MLE Results</i>				
Spatial lag of minimum wages	0.16*** (0.04)	0.18*** (0.05)	0.38*** (0.08)	0.92*** (0.02)
Controls	Yes	Yes	Yes	Yes
City FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Observations	2016	2016	2016	2016
<i>Panel B: IV/GMM Results</i>				
Spatial lag of minimum wages	1.42*** (0.30)	0.73*** (0.27)	1.12*** (0.28)	1.07*** (0.07)
Controls	Yes	Yes	Yes	Yes
City FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Observations	2016	2016	2016	2016
R2	0.88	0.90	0.90	0.96
Kleibergen-Paap rk Wald F statistics	52.84	49.98	225.00	179.60
Hansen J statistic	0.52	0.40	0.49	0.23
<i>Panel C: Arellano-Bond GMM Results</i>				
Spatial lag of minimum wages	0.63*** (0.15)	0.32** (0.15)	0.98*** (0.19)	1.19*** (0.04)
L. min wage	0.10** (0.04)	0.14*** (0.05)	0.08* (0.04)	0.09*** (0.03)
Controls	Yes	Yes	Yes	Yes
City FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Observations	1512	1512	1512	1512
Hansen J P-value	0.737	0.747	0.736	0.781
AR (2) p-value	0.395	0.250	0.414	0.371

Notes: Each column uses a different weighting matrix to construct the spatial lag. Column (1) uses 2003 GDP (log); column (2) labour force participation rate; column (3) the number of enterprises; and column (4) combines inverse distance and per capita GDP. Panel A shows MLE estimation results for each model; Panel B presents IV/GMM estimation results; Panel C uses the Arellano-Bond difference GMM estimation method, using all lagged terms as instruments. Control variables are taken a one-year lag. Robust standard errors in parentheses are clustered at the city level. ***p < 0.01, **p < 0.05, *p < 0.1.

review of minimum wages in Africa. They find that ‘most countries in sub-Saharan Africa (SSA) have adopted minimum wage regulation’ (p. 47) and that ‘SSA as whole reflects no particular bias towards a more aggressive minimum wage policy compared to the rest of the world’ (p. 1). In South Africa, for example, the current government has proposed a national minimum wage to replace the collection of sector and region-specific minimum wages. The question of whether to allow local setting of minimum wages to take account of local conditions is an area of open debate. In Asia, the decentralisation reforms in Indonesia were accompanied by a decree allowing local governments to set minimum wages. As countries like Myanmar start a new era of labour regulation, the questions of minimum wages and local flexibility in implementation are at the forefront. In Russia, minimum wage setting was decentralised in 2007. Around the world, therefore, interjurisdictional competition in minimum wages is a live issue. Our analysis provides an initial framework in which competing perspectives on these debates can be assessed quantitatively.

Table 5. Robustness of enforcement competition to alternative weighting matrices

	2003 GDP (log)	Labour force part. rate	# of enterprise	Distance + (log) per cap GDP
	(1)	(2)	(3)	(4)
<i>Panel A: MLE Results</i>				
Spatial lag (violation rate)	0.06 (0.09)	0.20*** (0.06)	0.21* (0.11)	0.13* (0.07)
Controls	Yes	Yes	Yes	Yes
City FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Observations	396	396	396	396
<i>Panel B: IV/GMM Results</i>				
Spatial lag (violation rate)	0.18 (0.61)	0.15 (0.40)	0.09 (0.48)	0.26 (0.54)
Controls	Yes	Yes	Yes	Yes
City FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Observations	396	396	396	396
R2	0.46	0.48	0.47	0.47
Kleibergen-Paap rk Wald F statistics	8.33	9.18	9.64	5.34
Hansen J statistic	0.59	0.69	0.73	0.10
<i>Panel C: Arellano-Bond GMM Results</i>				
Spatial lag (violation rate)	0.68* (0.35)	0.72** (0.32)	0.70** (0.33)	0.26 (0.36)
L. min wage violation rate	-0.05 (0.12)	-0.16 (0.13)	-0.07 (0.08)	-0.06 (0.12)
Controls	Yes	Yes	Yes	Yes
City FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Observations	264	264	264	264
Hansen J P-value	0.701	0.744	0.535	0.887
AR (2) p-value	0.419	0.461	0.138	0.114

Notes: Each column uses a different weighting matrix to construct the spatial lag. Column (1) uses 2003 GDP (log); column (2) labour force participation rate; column (3) the number of enterprises; and column (4) combines inverse distance and per capita GDP. Panel A show MLE estimation results for each model; Panel B presents IV/GMM estimation results; and Panel C uses Arellano-Bond difference GMM estimation methods, using lagged terms as instruments. Control variables are taken a one-year lag. Robust standard errors in parentheses are clustered at the city level. ***p < 0.01, **p < 0.05, *p < 0.1.

Our evidence on jurisdictional interdependence in minimum wage setting within a country also raises a set of interesting further research questions. What we have shown is that local government react to each other in setting minimum wages, and in the enforcement of minimum wages. A natural interpretation of that is a possible ‘race to the bottom’, as jurisdictions lower labour standards to attract investment. But could there also be a ‘race to the top’ in other dimensions? Rather than lower labour standards, a local government could improve infrastructure, or improve the quality of local governance, to make investment more attractive. This could set in motion a chain of reactions through which other localities respond by improving their infrastructure and business environment so that there is an upward virtuous cycle of overall improvement in labour productivity rather than a downward vicious spiral of lowering labour costs through lowering labour standards. This raises the

empirical question – do we see such a virtuous race to the top in practice? And the policy question – what can the government do to trigger the virtuous spiral?

Notes

1. Examples of other papers on tax competition, environmental regulation competition, and welfare competition include: Allers & Elhorst (2005); Brueckner & Saavedra (2001); Edmark & Agren (2008); Fredriksson & Millimet (2002); Konisky (2007); Markusen, Morey, & Olewiler (1995); and Plümper, Troeger, & Winner (2009).
2. China's administrative structure includes, from high to low levels, provinces, prefecture-level cities, and counties. A prefecture-level city comprises a central urban area and several counties.
3. In the case that there are multiple levels of minimum wage standards within one prefecture-level city, we use the highest one as that prefecture-level city's minimum wage level. In (rare) cases of two upward adjustments happening within one year (for example, Hebei Province and Beijing city in 2007), we take the second (and higher) one as that year's minimum wage standard.
4. China Data Online originally includes 286 cities. By combining it with minimum wage data and generating a city-level data set, we lost 25 prefecture-level cities. Later, we lose one city when combining with the shapefile data set and drop one city because it is not present in all years. As a result, we get seven 'island' cities that have no neighbouring cities. We drop these 'islands' when constructing the contiguity weighting matrix, and thereby lose seven additional cities. Provincial-level units absent in the sample are Gansu, Qinghai, Xinjiang, Guizhou, Hainan, Guizhou, Tibet, Hongkong, and Macao.
5. The results of t-test statistics for each economic variable is available upon request.
6. The results of t-test statistics for each economic variable is available upon request.
7. Individual monthly wage is derived by annual income/the number of months worked in the year.
8. Other studies using the Spatial Lag framework include, for example, Brueckner & Saavedra (2001); Davies & Vadlamannati (2013); Edmark & Agren (2008); Konisky (2007); Ollé (2003); Olney (2013); Plümper et al. (2009); Shi & Xi (2018); Yu et al. (2016).
9. A critique by Lyttikäinen (2012) is that the cross-sectional maximum likelihood Spatial Lag estimation and Spatial IV model overestimate the degree of interdependence in tax rates, as compared to the policy change IV estimates. However, the author finds that the inclusion of municipality fixed effects in the panel data model significantly reduces the bias (in the analysis of general property tax). By this logic, as our model already takes advantage of panel data and includes city fixed effects, we expect that any potential (upward) bias would become minimum.
10. Industry share in total GDP = Secondary industry GDP / total GDP. Labour force participation = the number of employees / population. The student enrolment in secondary and primary schools and the number of hospital beds are all standardised by population.
11. Our results remain when using two-year or three-year lags, but for the sake of sample size we use one-year lags.
12. The estimation results are robust to using fewer lagged levels as instruments, and robust to using the Blundell and Bond (1998) SYS-GMM method instead of difference GMM. The central idea of the instruments is that, y_{it-2} is orthogonal to the differenced error term $\Delta\epsilon_{it}$, or $E(y_{it-2}\Delta\epsilon_{it}) = 0$. Stata command is xtabond2 (Roodman, 2006).

Acknowledgements

We thank Professor Chunbing Xing from Beijing Normal University in China for kindly sharing minimum wage data. We would like to show our great gratitude for Dr. Haoying Wang from Cornell University for his assistance with GIS software, and for his insightful discussion on spatial econometrics. We are also immensely grateful to Professor Larry Kahn and Victoria Prowse for their comments on an earlier version of the manuscript. Any errors are our own and should not tarnish the reputations of these esteemed persons.

Disclosure statement

No potential conflict of interest was reported by the authors.

Funding

This research was supported by the Fundamental Research Funds for the Central Universities [grant number 2018NTSS60].

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Appendix**Table A1.** Descriptive statistics, 2004–2012

	N	Mean	Std. Dev	Min	Max
GDP (log)	2,268	5.7	1.2	2.5	9.9
per capita GDP (log)	2,268	10.3	0.7	8.0	12.6
Labour participation Rate (%)	2,268	17.6	10.4	1.8	97.4
Industry share (%)	2,268	51.5	12.0	8.0	89.0
# of enterprises (1000)	2,268	0.6	1.4	0.0	18.5
# of beds in hospitals (per 100 people)	2,268	0.5	0.2	0.0	2.5
Student enrol in secondary school (per 100 people)	2,268	6.6	2.6	0.9	71.6
% of secondary employment	2,268	47.6	14.0	3.8	81.9
Student enrolment in primary school (per 100 people)	2,268	7.8	3.0	1.1	32.5
Minimum wages (deflated by 2002 CPI)	2,268	530.3	155.9	212.0	1164.2
Kaitz ratio (%)	396	38.0	9.1	18.6	72.0

Notes: Industry share in total GDP = Secondary industry GDP/total GDP. Labour force participation = the number of employees/population. The student enrolment in secondary schools, the student enrolment in primary schools and the number of hospital beds are all standardised by population. Kaitz ratio is equal to minimum wage divided by median wage.