



THE OHIO STATE UNIVERSITY

“How will China maintain its international competitiveness?”*

Ian Sheldon

Andersons Professor of International Trade



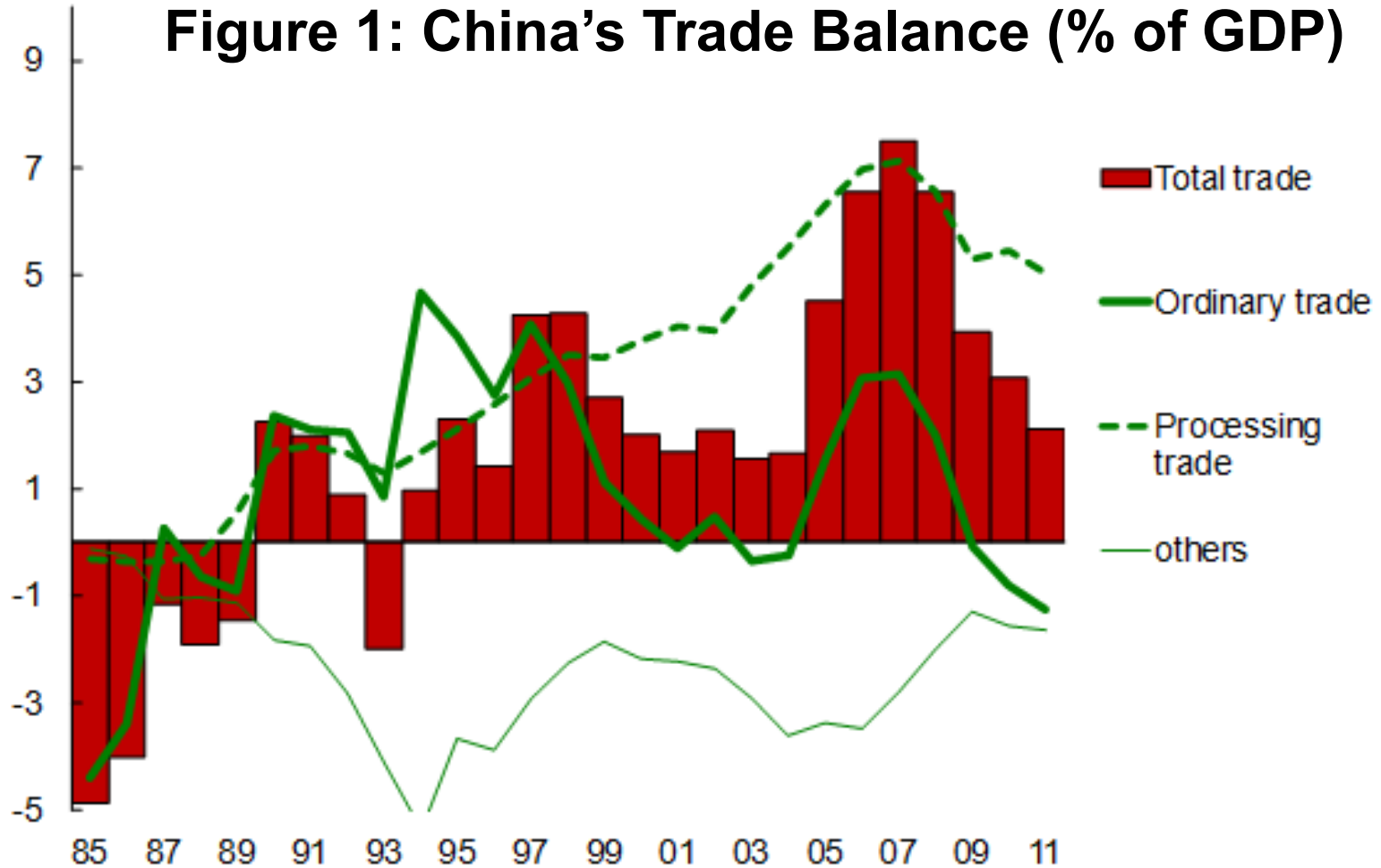
- **Despite global recession, value of China's total trade accounted for 48% of GDP in 2011**
- **China recently became world's largest trading economy, trade being significant factor in its economic growth**
- **US and EU industry have both faced increase in import competition from China without offsetting increase in exports**
- **Notwithstanding net benefits of trade, negative impact on employment and wages in US import-competing industries**



- **China's expanded participation in trade driven by:**
 - migration of 150 million workers
 - access to technology, capital and inputs
 - entry of multinational firms
 - accession to WTO in 2001
- **Through 2000s, China maintained trade surplus at an average of 5% of its GDP (figure 1)**
- **Major contributor to global economic imbalances, China being accused of intentionally undervaluing its currency**



Figure 1: China's Trade Balance (% of GDP)

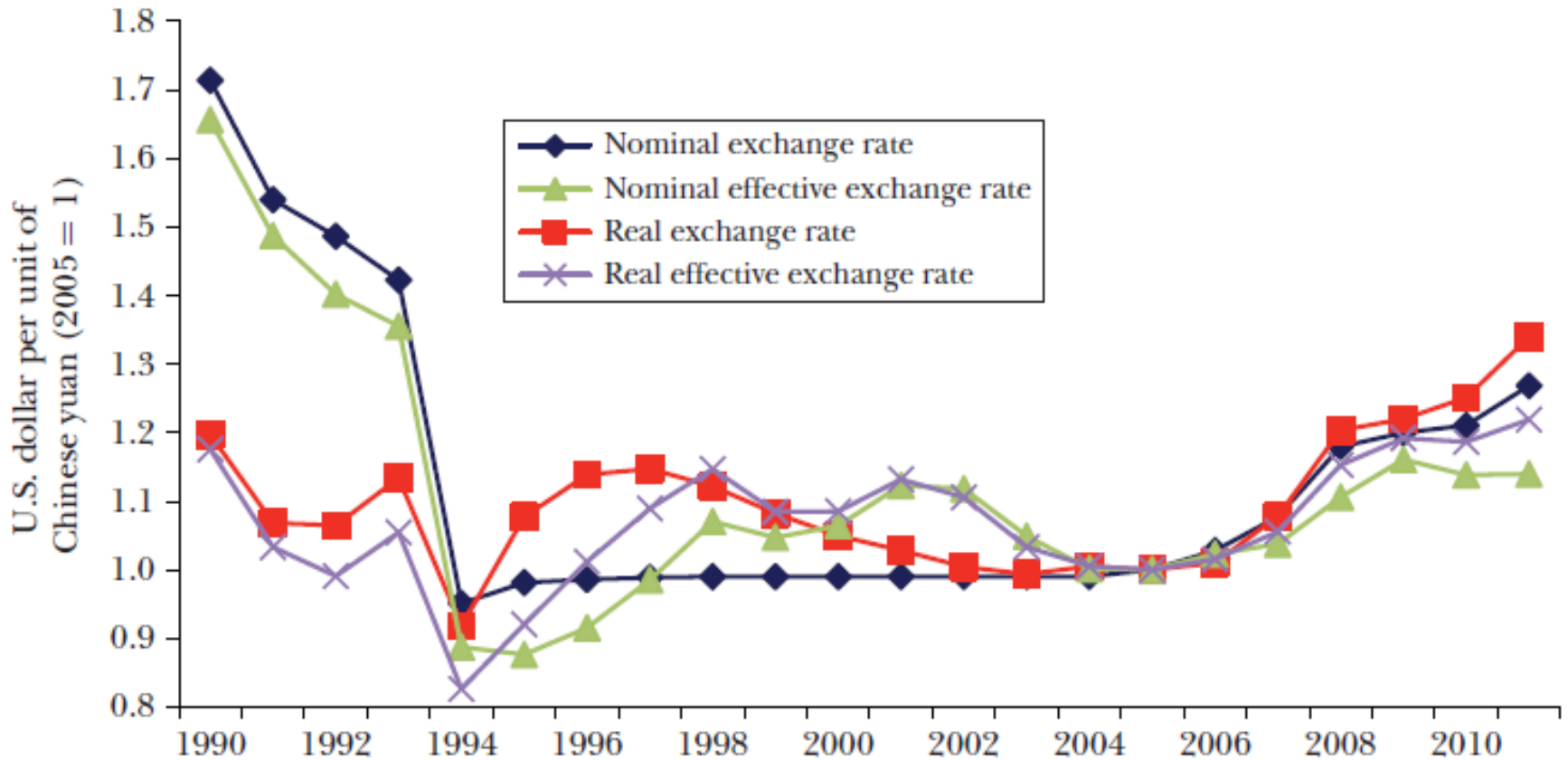




- **Since 2005, China's nominal exchange rate has appreciated by 30% - insufficient to prevent trade surplus rising (figure 2)**
- **Despite weaker global demand after 2008, China continues to run bilateral surplus with US and EU (figure 3)**
- **Trade deficit with Asia due to it being part of "factory Asia", i.e., China imports components and exports finished goods to rest world**
- **China's trade deficits with Africa and Middle East based on demand for commodities (oil, copper, iron-ore, nickel and tin)**



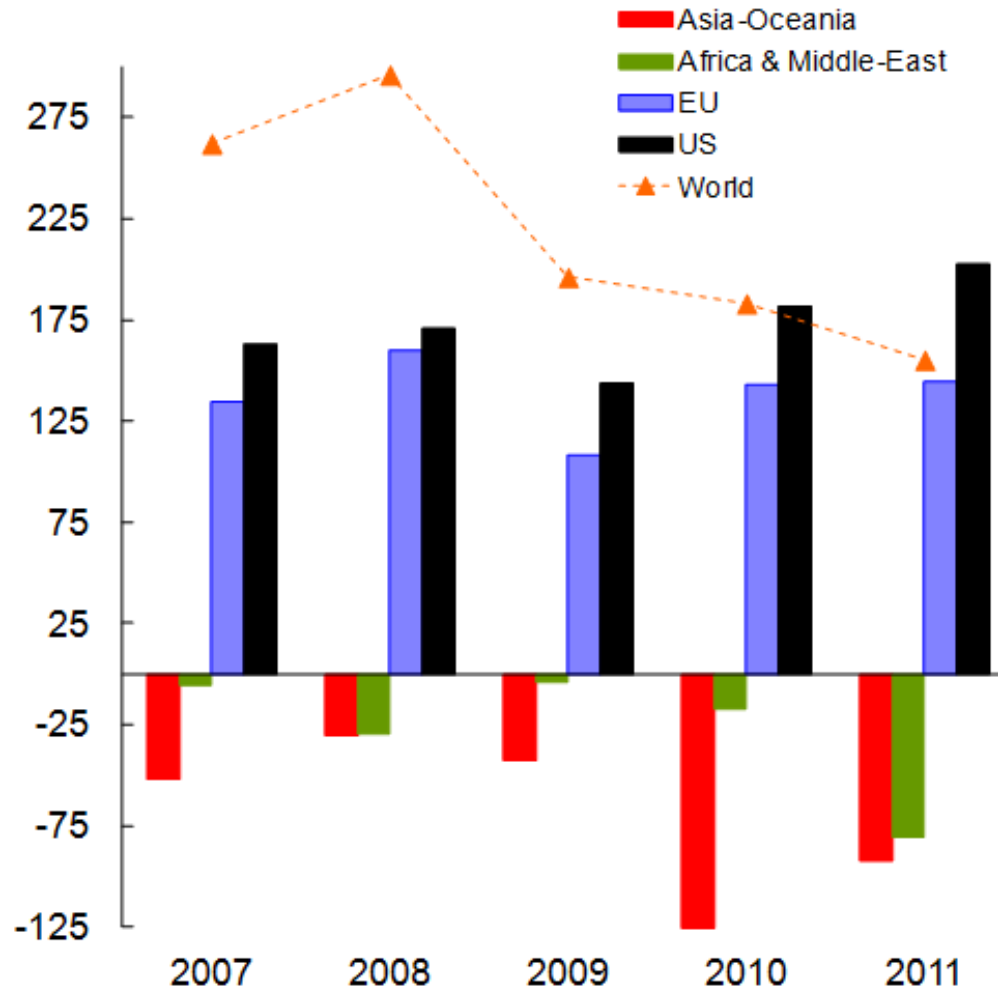
Figure 2: RMB Exchange Rate Against US\$, 1990-2011



Source: IMF (2012)



Figure 3: China's Trade Balance by Regions (US\$ billion)





- **China has competitive edge in labor-intensive industries – shifting over past decade from footwear and toys to electronics (figure 4)**
- **Due to availability of cheap labor, multinational firms have outsourced assembly to China**
- **Triggered fast employment growth and rural-urban migration**
- **Over 2000s, China's average real wages rose by 13.8%/annum (figure 5) – higher than other economies in Asia (figure 6)**
- **Real exchange rate has also risen (figure 2) - multinational firms may outsource from elsewhere**



Figure 4: China's Top Export Products

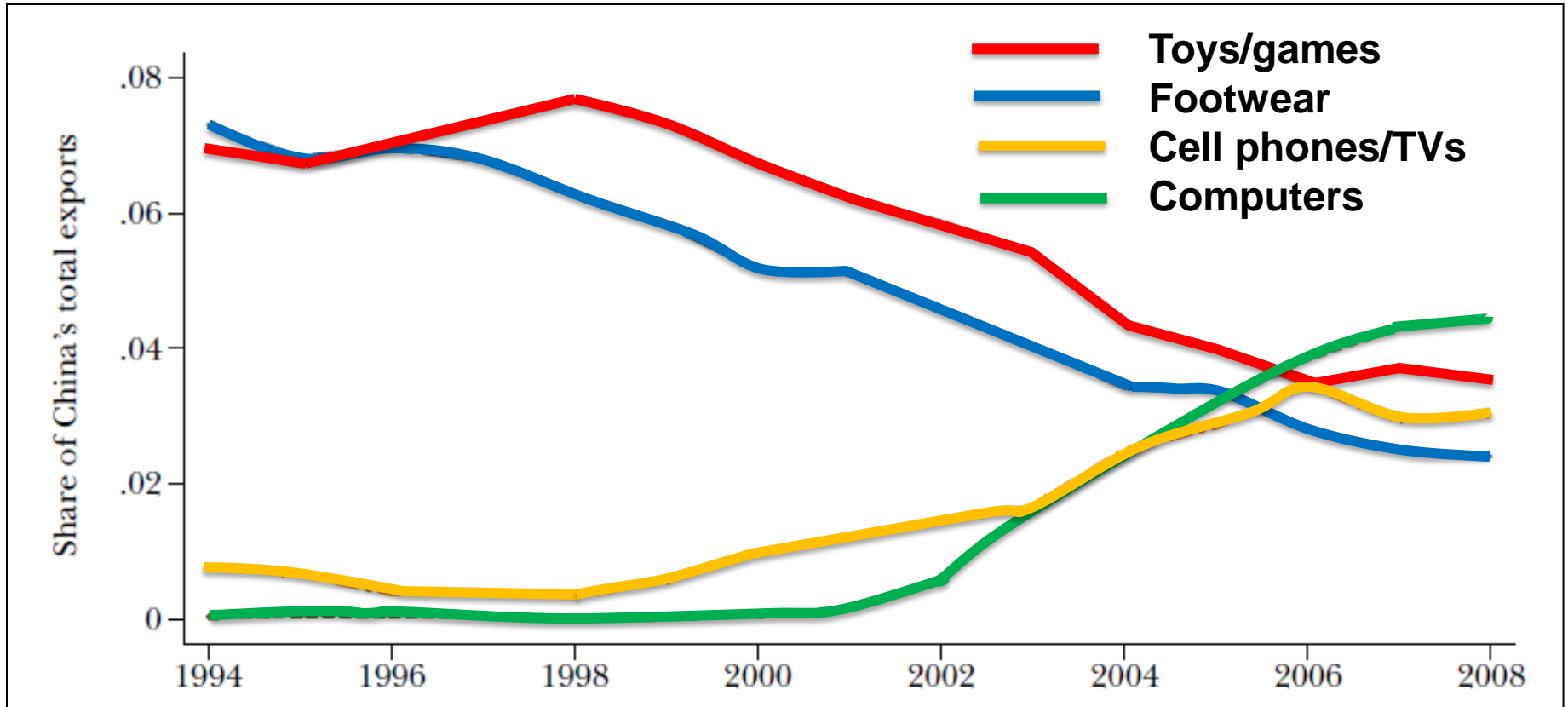
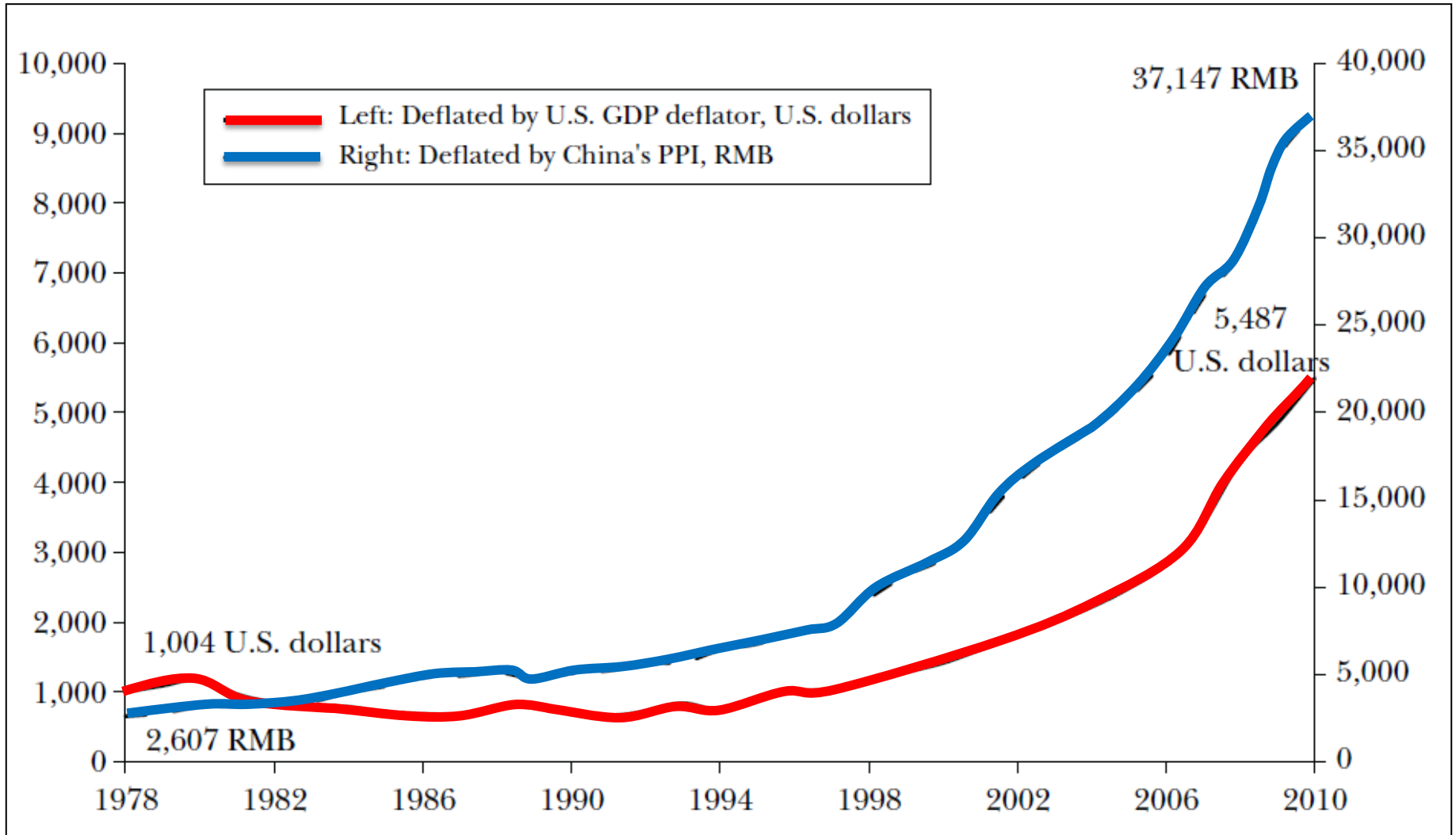




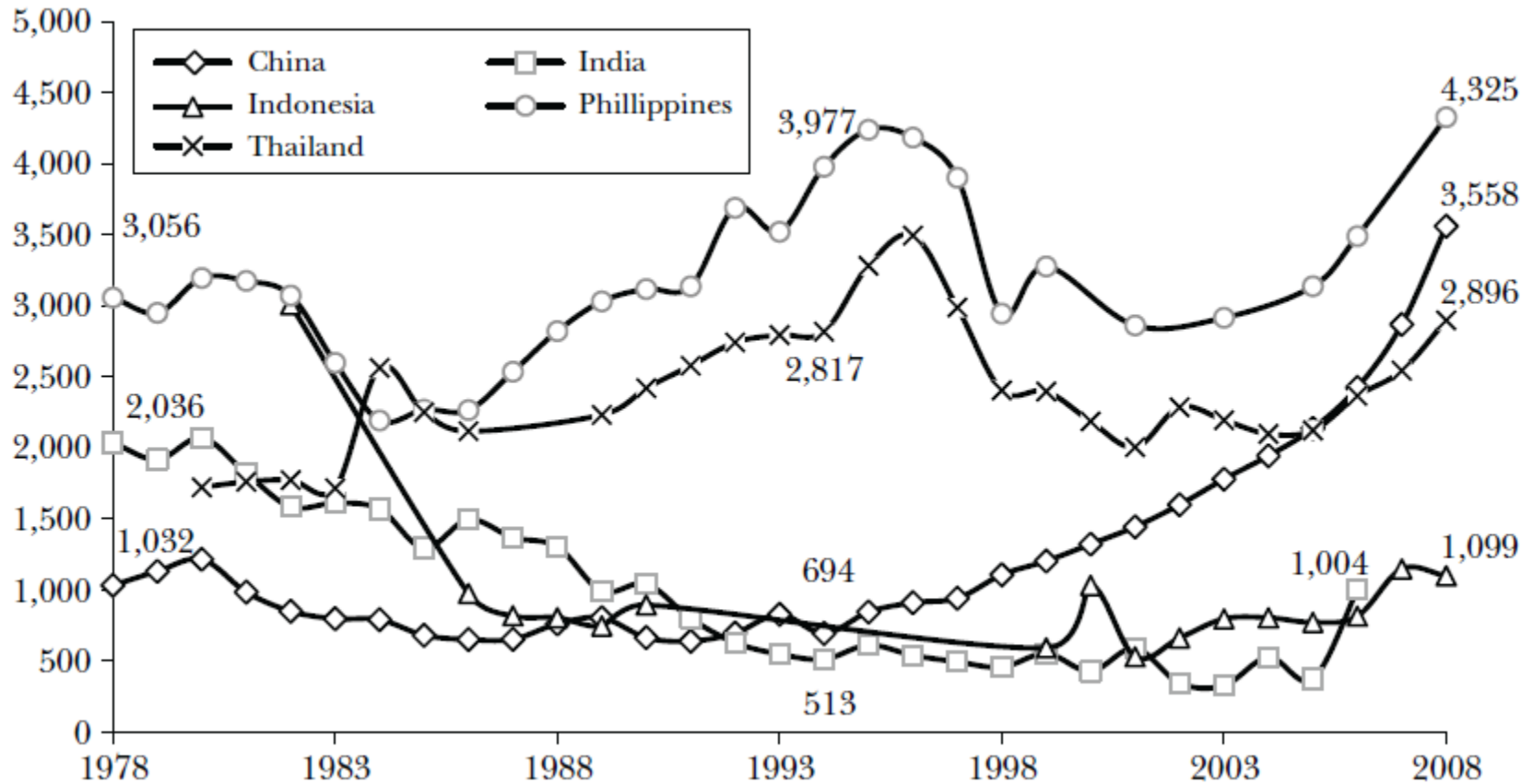
Figure 5: Real Annual Wages of Chinese Urban Workers (2010 prices)



Source: Li et al., 2012



Figure 6: Manufacturing Wages in Emerging Asia (2010 dollars)



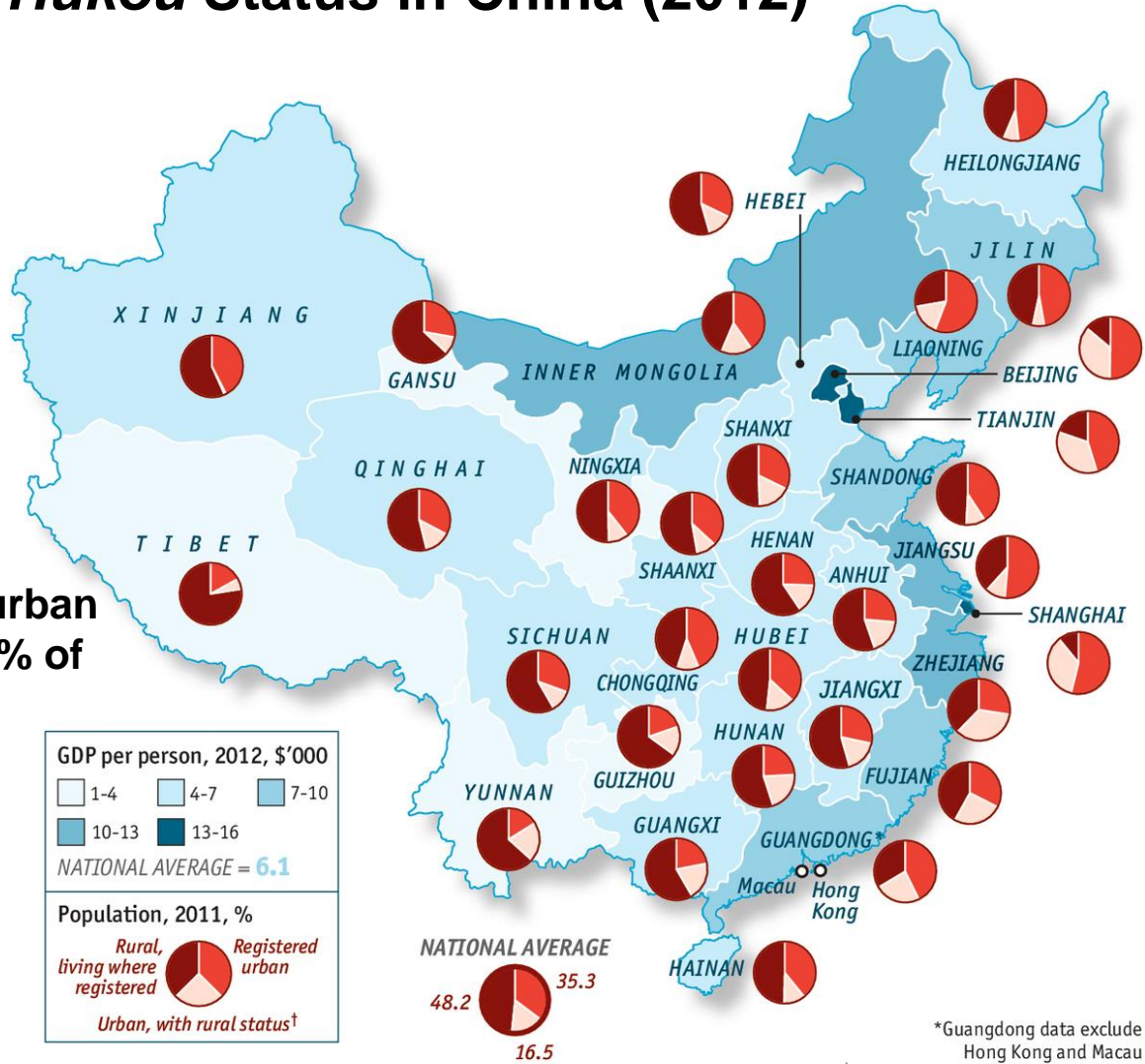


- **Why rising wages?**
 - **reforms to urban labor markets mean private sector is setting wages linked to productivity**
 - **slower growth in China's labor force due to declining birthrate – 1.4 births/woman by 2010**
 - **migration influenced by *hukou* residency system – rural residents allowed to migrate but cannot take advantage of urban public services**
 - **cost of migration has created surplus of labor in rural areas and rising migrant wages in urban areas**



Figure 7: *Hukou* Status in China (2012)

2012: 270 million living in urban areas had rural *hukou* – 40% of urban population



Sources: Haver Analytics; *The Economist* estimates

*Guangdong data exclude Hong Kong and Macau
[†]Registered as rural, living elsewhere



- **Has China hit “Lewis” (1954) turning point?**
 - **emerging economies initially have small manufacturing sector alongside rural sector with surplus labor**
 - **surplus labor ensures low wages as economy grows, and no diminishing returns to capital**
 - **as wages start to rise, turning point reached, and more capital has to be applied to workforce – “capital deepening”**
 - **debate over whether turning point has actually been reached**



- **Competitiveness also depends on productivity – grown at 11.3%/annum over past decade**
- **Increased investment in R&D and capital/worker**
- **Greater access to college education has raised quality of labor and returns to education in China (figure 8)**
- **If productivity growth continues at this rate, China will switch to manufacturing more skill-intensive, and higher value-added goods (figure 9)**
- **However, growing divide between rural and urban education opportunities – university expansion having benefited urban areas much more**



Figure 8: Returns to Education in Urban China

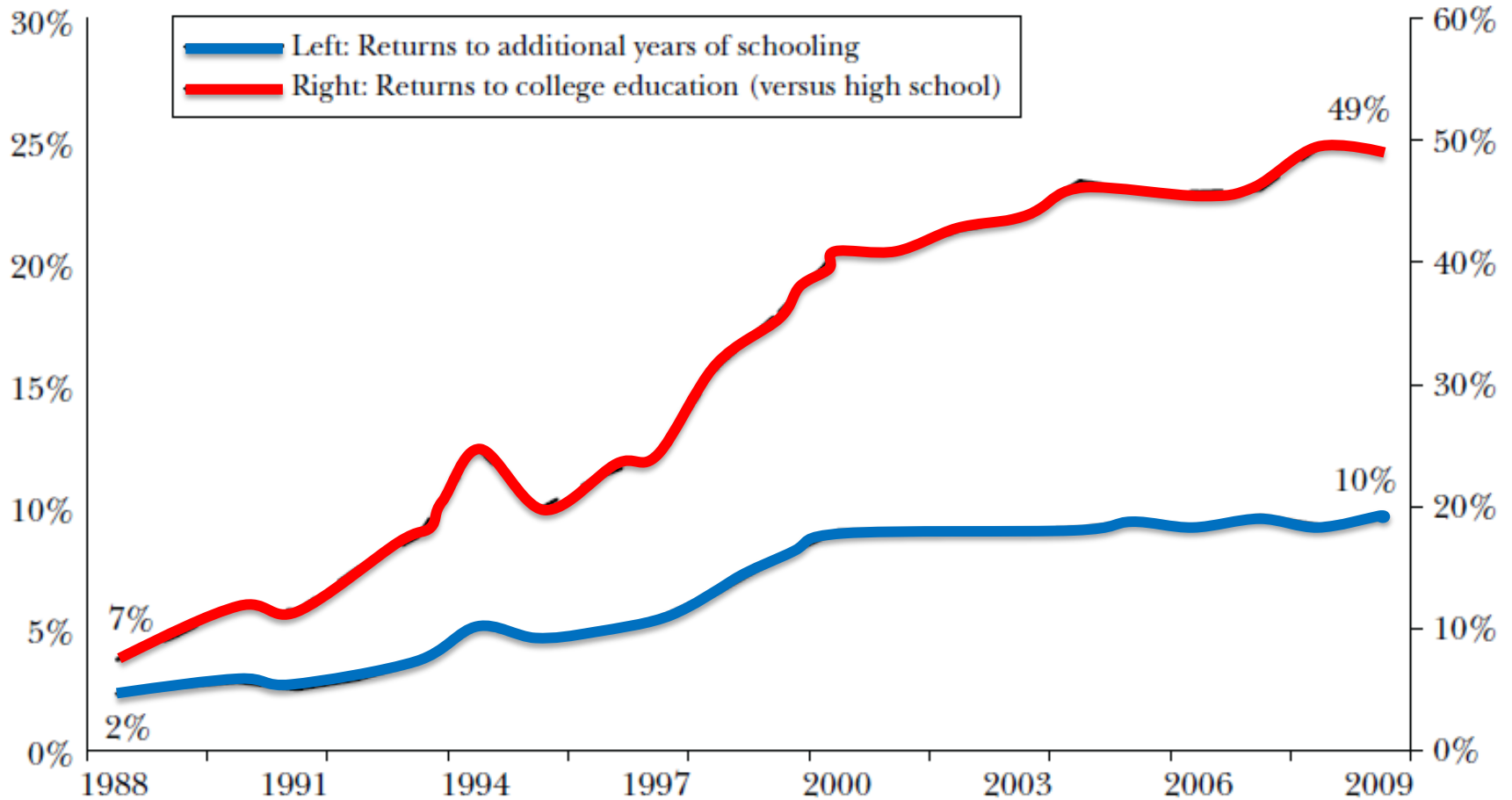
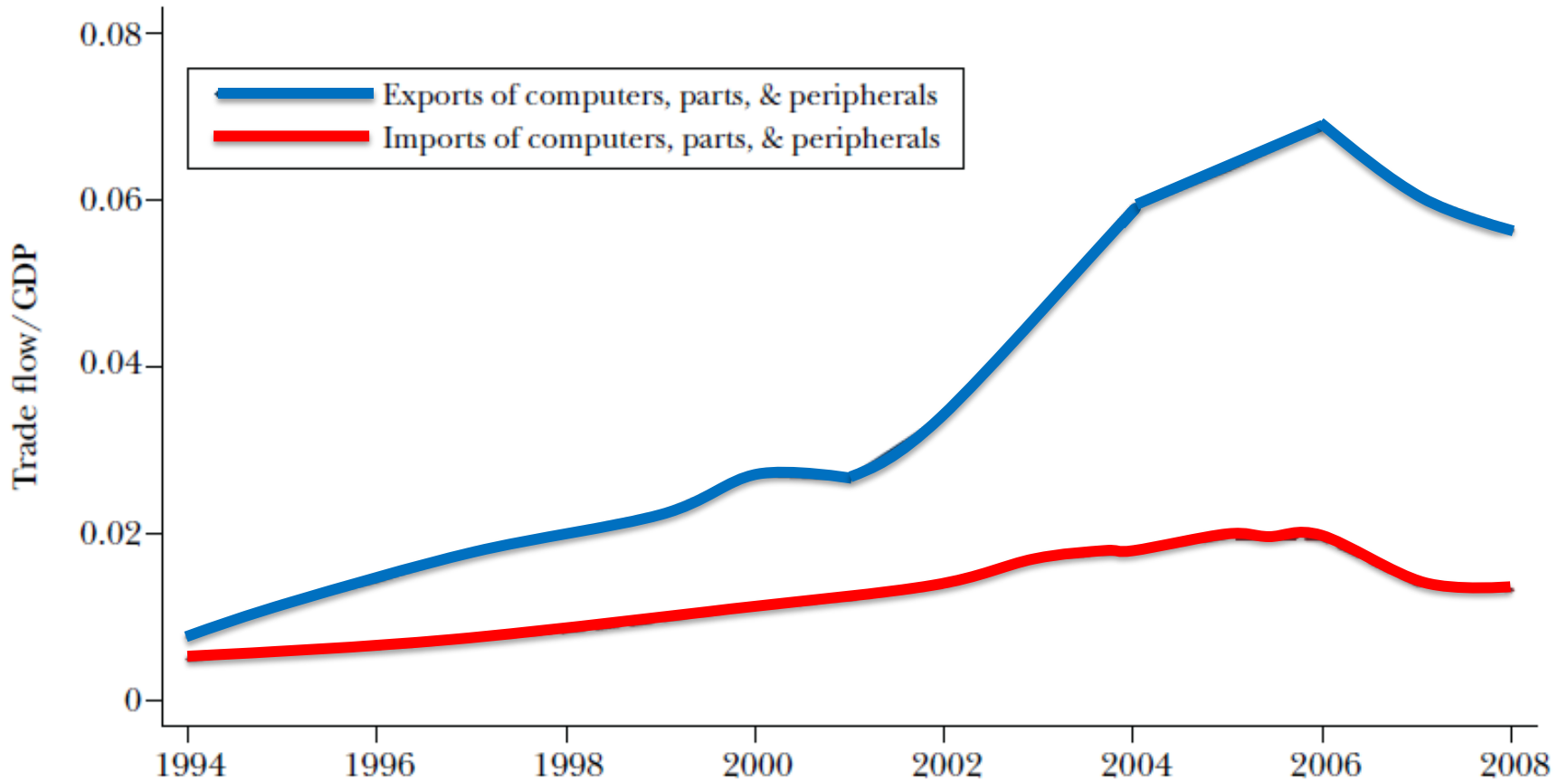




Figure 9: China's Imports and Exports of Computer Parts





- **For China to transition smoothly to more skill-intensive, middle-wage economy, labor and rural land market reforms essential**
- **Cost of migration could be reduced through relaxation of urban *hukou* privileges, but there are constraints:**
 - **\$8.2 trillion required to accommodate 100 million new migrants by 2020 (China Development Bank)**
 - **Urban dwellers want to maintain preferential access to jobs, education and health care**



- **Holders of rural *hukou* have high savings rates – need to release consumption potential and aid in rebalancing of China’s economy**
- **Rural land and home ownership rights should be established, allowing farmers to sell up and migrate to cities**
- **Collective control of land is a problem – local governments can dispossess farmers of land they lease – 16.5 million acres over 1990-2010 period**
- **However, local experiments allowing farmers to borrow against homes could be scaled up**



- **Changes to one-child policy probably over-played**
- **Urban population clearly started shrinking at time of one-child policy, but less strictly enforced in rural areas**
- **As more than 70% of population has rural *hukou*, limited effect of one-child policy on rural population dominates (figure 10)**
- **China's labor force will have to be predominantly drawn from rural areas**
- **Less a problem of migrant labor shortage and more an issue of constraints on migration and poor education of migrants**



Figure 10: China's Population Pyramid (2000)

