THE OHIO STATE UNIVERSITY

"How will China maintain its international competitiveness?"

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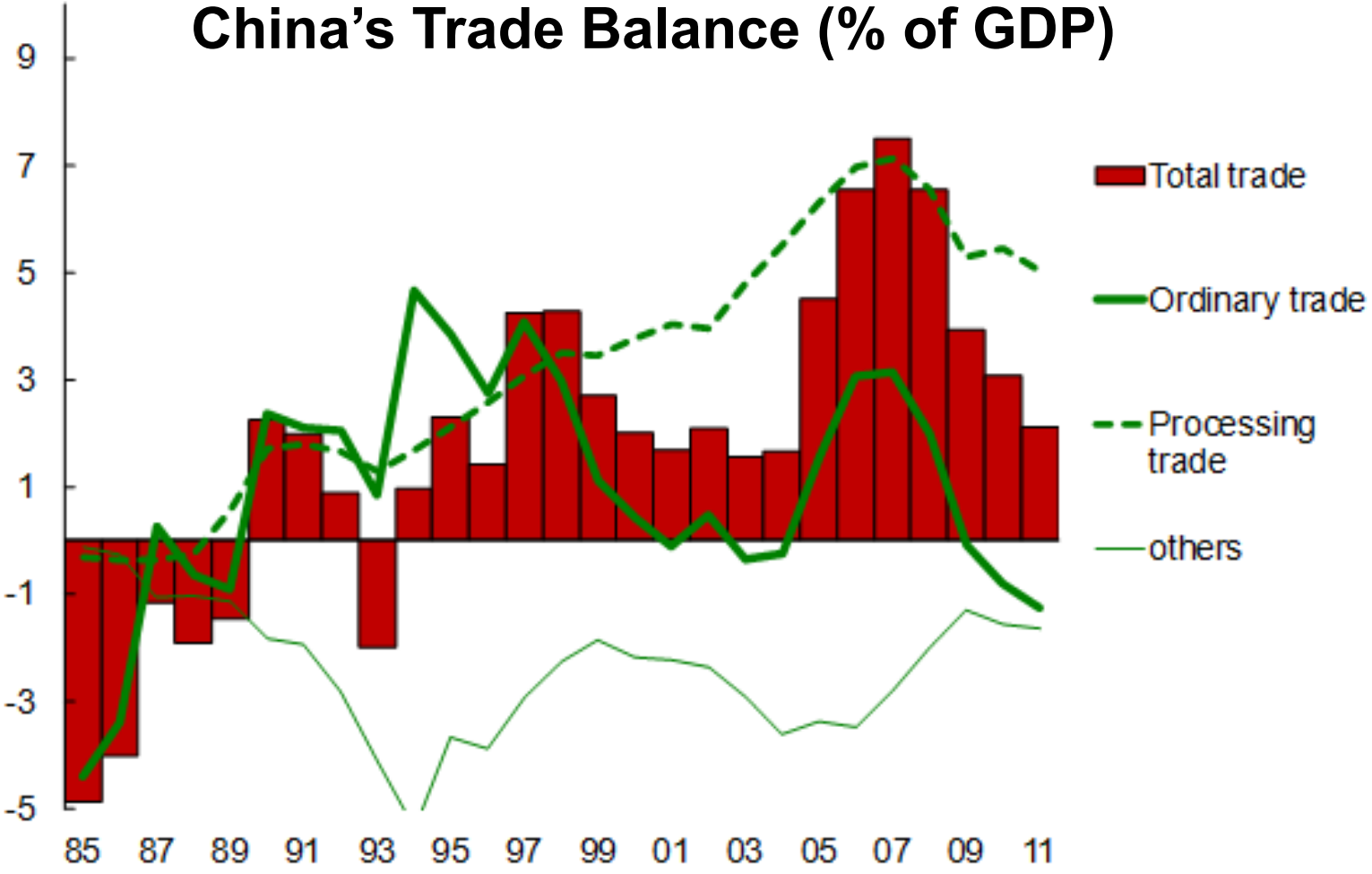
http://aede.osu.edu/about-us/publications/do-chinas-rising-wages-mean-end-its-competitive-edge-0

- **Despite global recession, value of China's total trade accounted for 48% of GDP in 2011**
- **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 – major contributor to global economic imbalances**

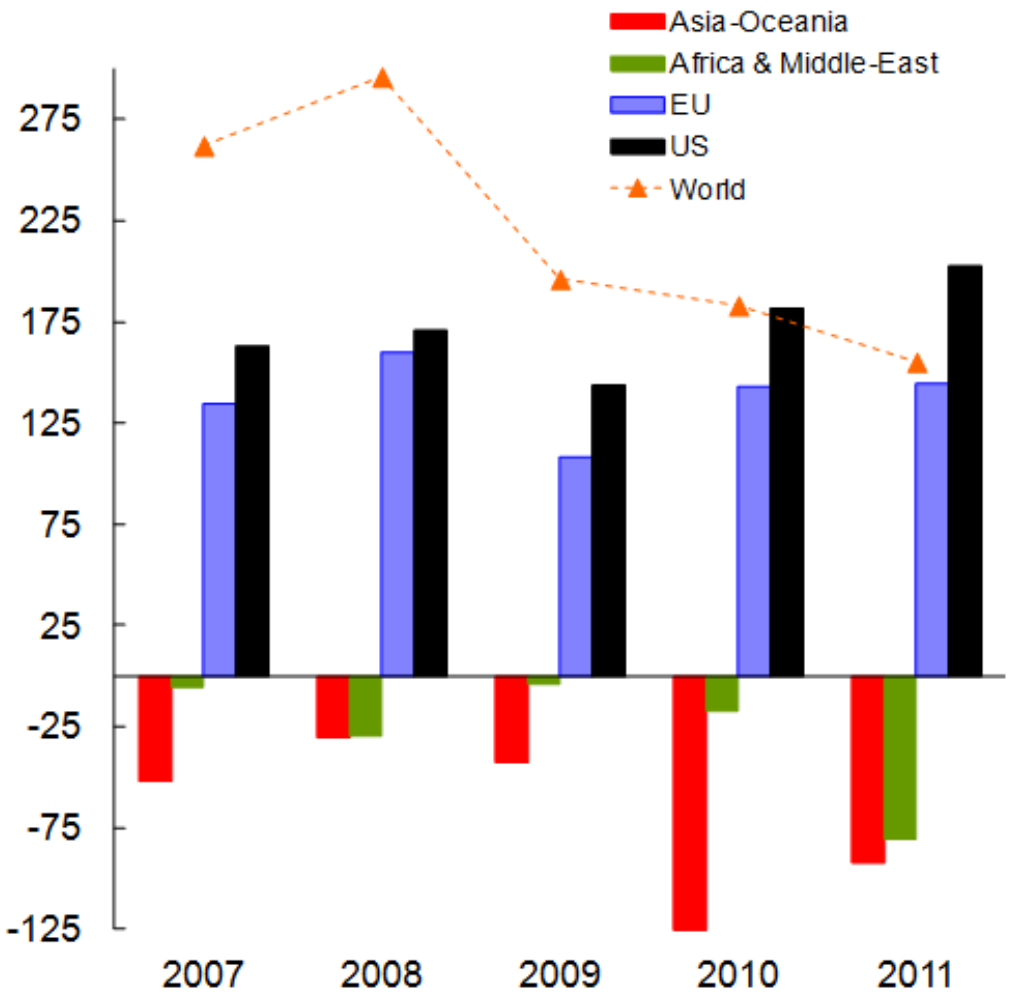
China's Trade Balance (% of GDP)



Source: Lemoine and Ünal, 2012

- **US and EU industry have faced increase in import competition from China without offsetting increase in demand for their exports**
- **Despite weaker global demand after 2008, China continues to run bilateral surplus with US and EU**
- **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)**

China's Trade Balance by Regions (US$ billion)

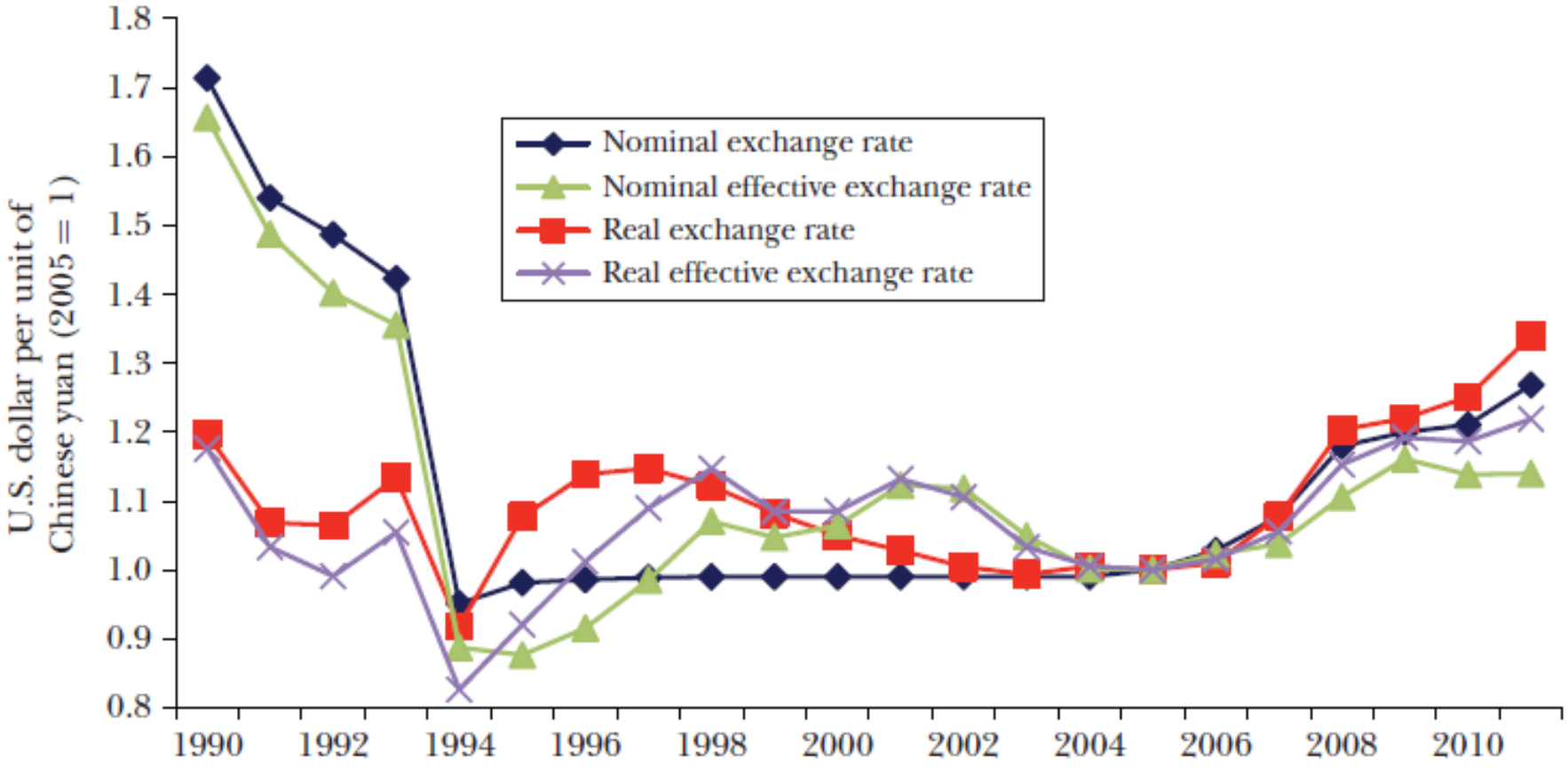


Source: Lemoine and Ünal, 2012

- **Historically, US imports from low-wage countries have been small, but this changed in 2000s**
- **1991-2007: US imports from China increased by 1,156% compared to US exports to China which increased by 456%**
- **Significant impact on US unemployment and wages in local labor markets with import-competing sectors (Autor et al., 2013)**
- **Has intensified concerns over perceived impact of China's exchange rate on US economy**
- **What has been role of China's exchange rate?**

- **Pre-1994: China maintained dual exchange rate - an official rate (5.77 RMB/$), and rate set in "swap market" (8.7 RMB/$)**
- **1994: two rates unified at 8.7 RMB/$, allowed to rise to 8.28 RMB/$ and pegged – essentially convertible on current account basis**
- **July 2005: a "managed float", whereby peg was relaxed, RMB appreciating 20.8% by July 2008**
- **July 2008-June 2010: exchange rate kept relatively constant at 6.83 RMB/$**
- **June 2010: RMB/$ appreciation resumed, value increasing 10.7% by July 2013**

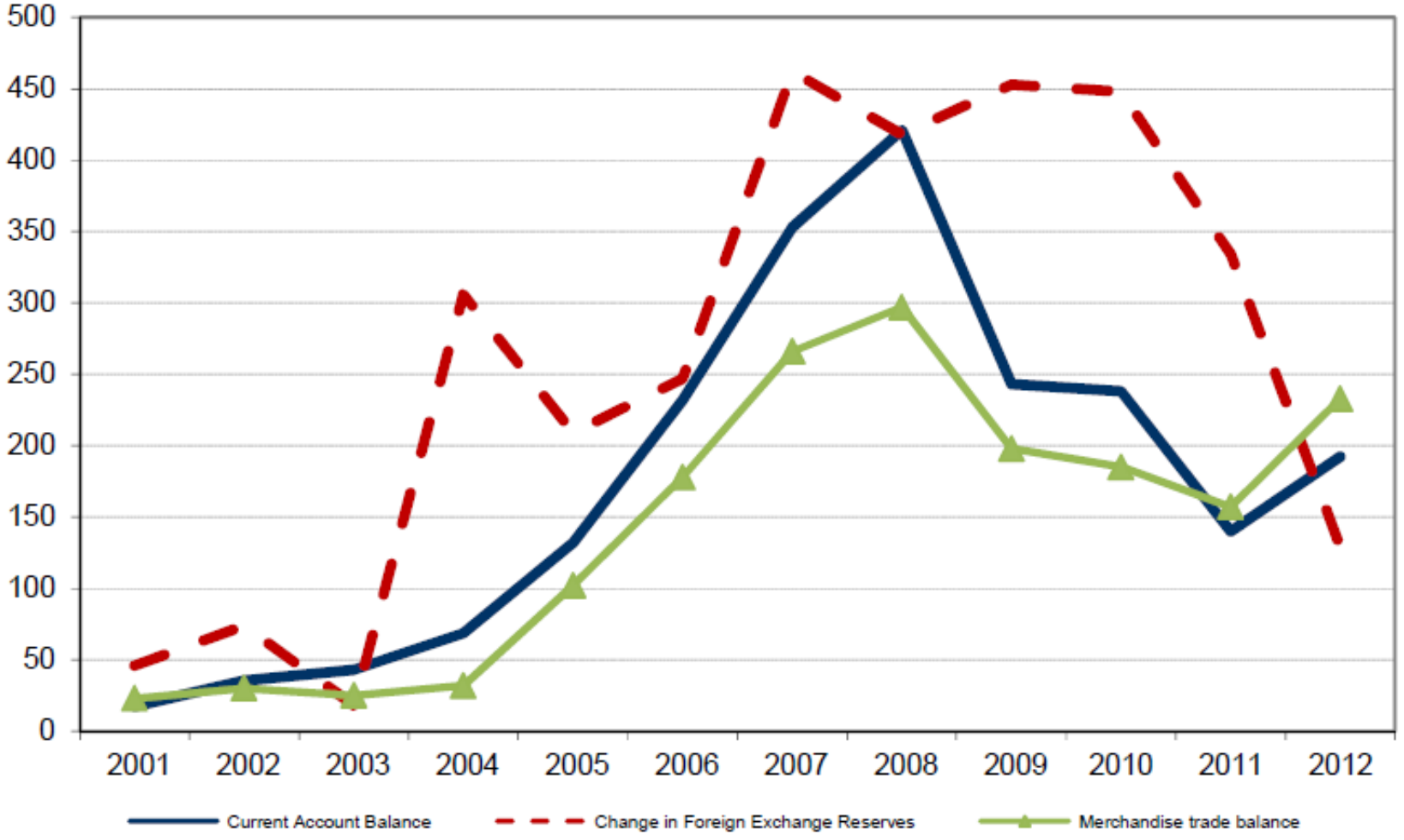
Figure 1: RMB Exchange Rate Against US$, 1990-2011



Source: IMF (2012)

- **Argued China deliberately manipulates currency, resulting in growth of US bilateral trade deficit with China - $325 billion in 2013**
- **Increases in foreign exchange reserves seen as evidence of Chinese manipulation of RMB**
- **Decline in China's trade surplus linked to RMB appreciation, but more likely due to falling global demand and foreign direct investment in China**
- **Nevertheless, some analysts claim US trade deficit and US job losses are correlated – hence, RMB appreciation will boost US jobs**

China's Trade Balance and Foreign Exchange Reserves

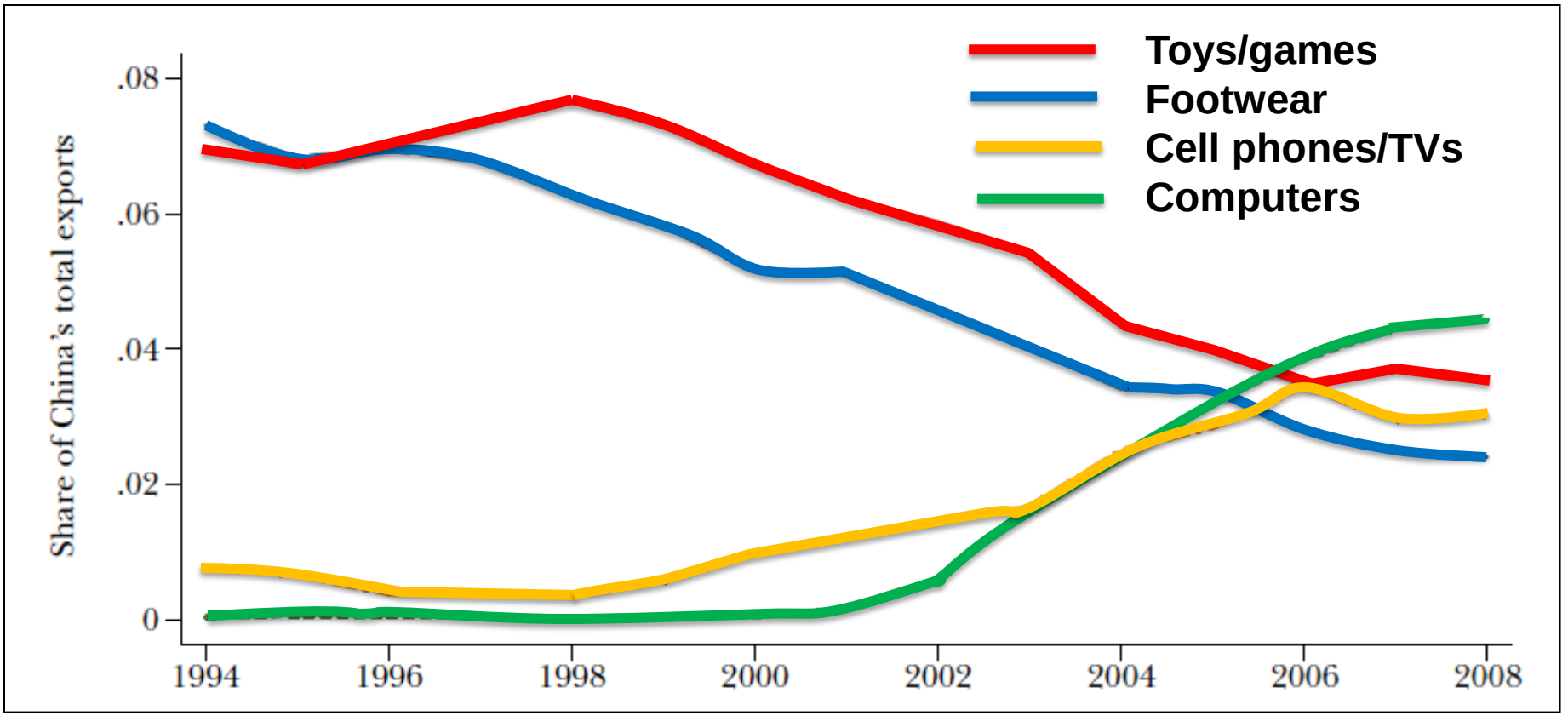


Source: EIU, IMF and CSAFE (2012)

- **Some argue China has managed exchange rate to provide an anchor for its inflation rate**
- **But if RMB is undervalued, common claim it is equivalent to an export subsidy-cum-import tariff**
- **Nominal depreciation only leads to temporary real depreciation - increase in import prices eventually feeds back into higher wages and domestic prices**
- **Hard to detect impact of RMB change on US-China trade: despite appreciation of RMB between 2005-08, US trade deficit with China grew by 30%**
- **So what has driven Chinese exports?**

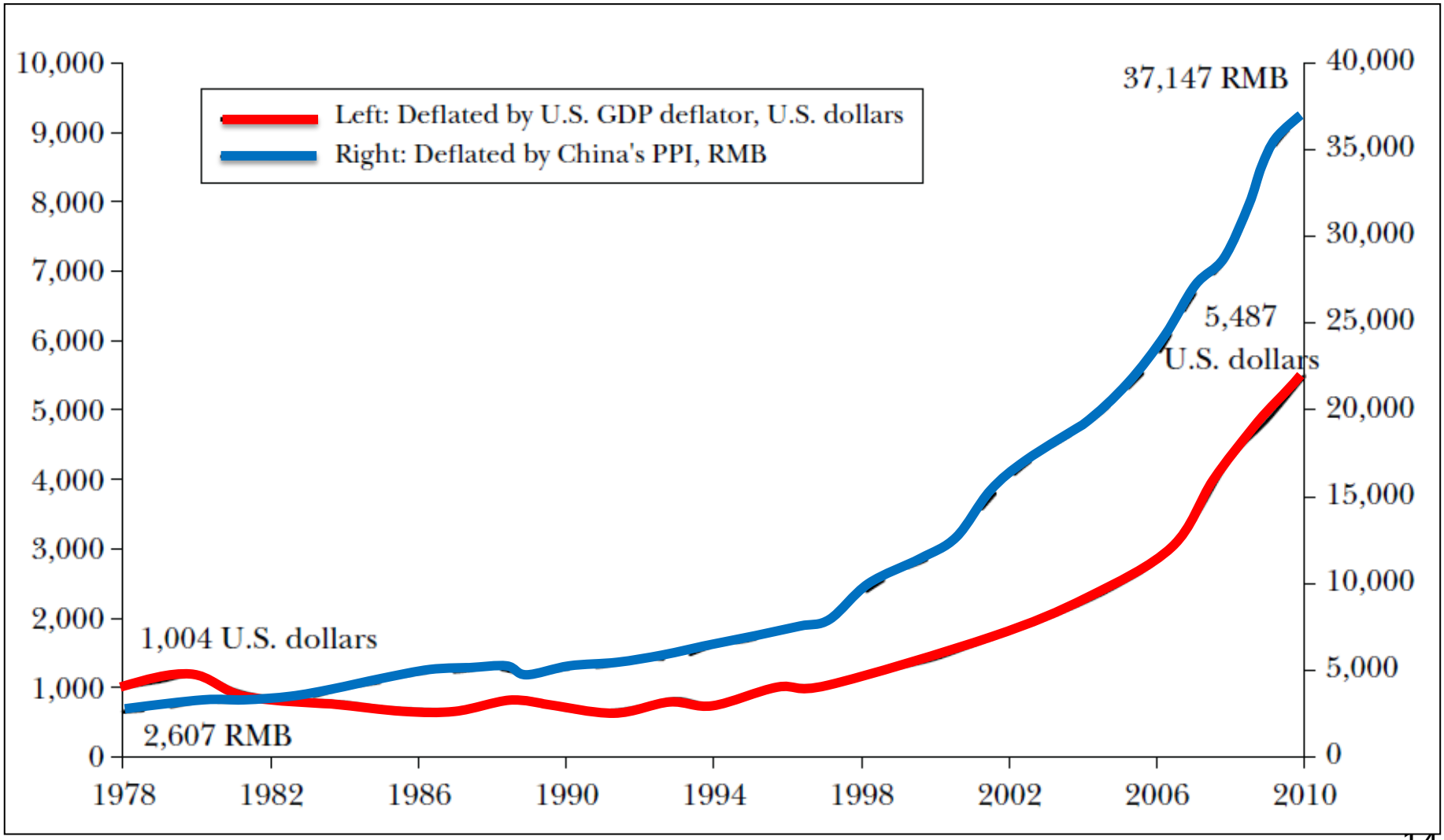
- China has competitive edge in labor-intensive industries – shifting over past decade from footwear and toys to electronics
- Due to availability of cheap labor, multinational firms have outsourced assembly to China
- Triggered fast employment growth and rural-urban migration
- Over 2000s, China's average real wages rose by 13.8%/annum - could reduce its competitiveness
- Real exchange rate has strengthened by 50% - multinational firms may outsource from elsewhere

China's Top Export Products



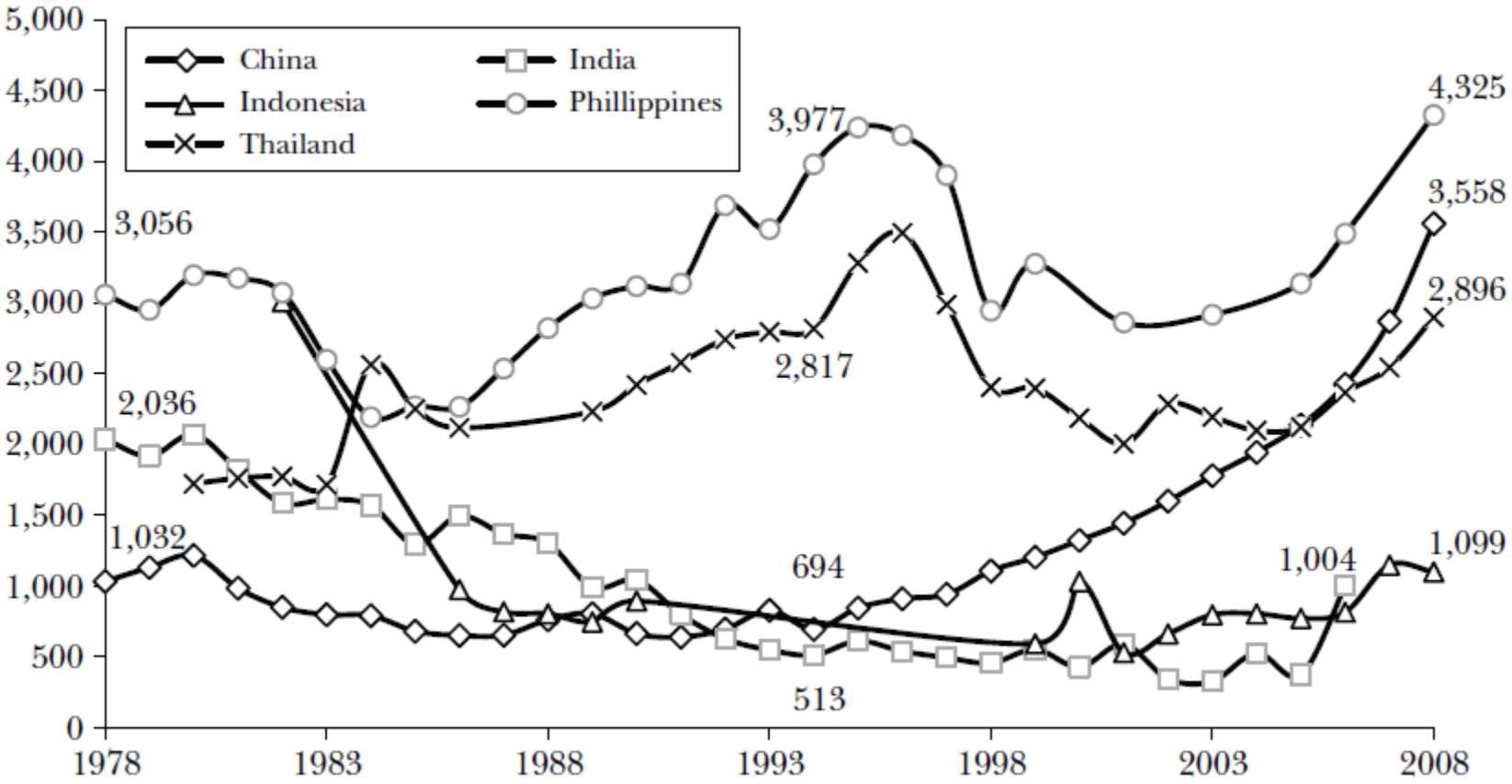
Source: Hansen 2012

Real Annual Wages of Chinese Urban Workers (2010 prices)



Source: Li et al., 2012

Manufacturing Wages in Emerging Asia (2010 dollars)



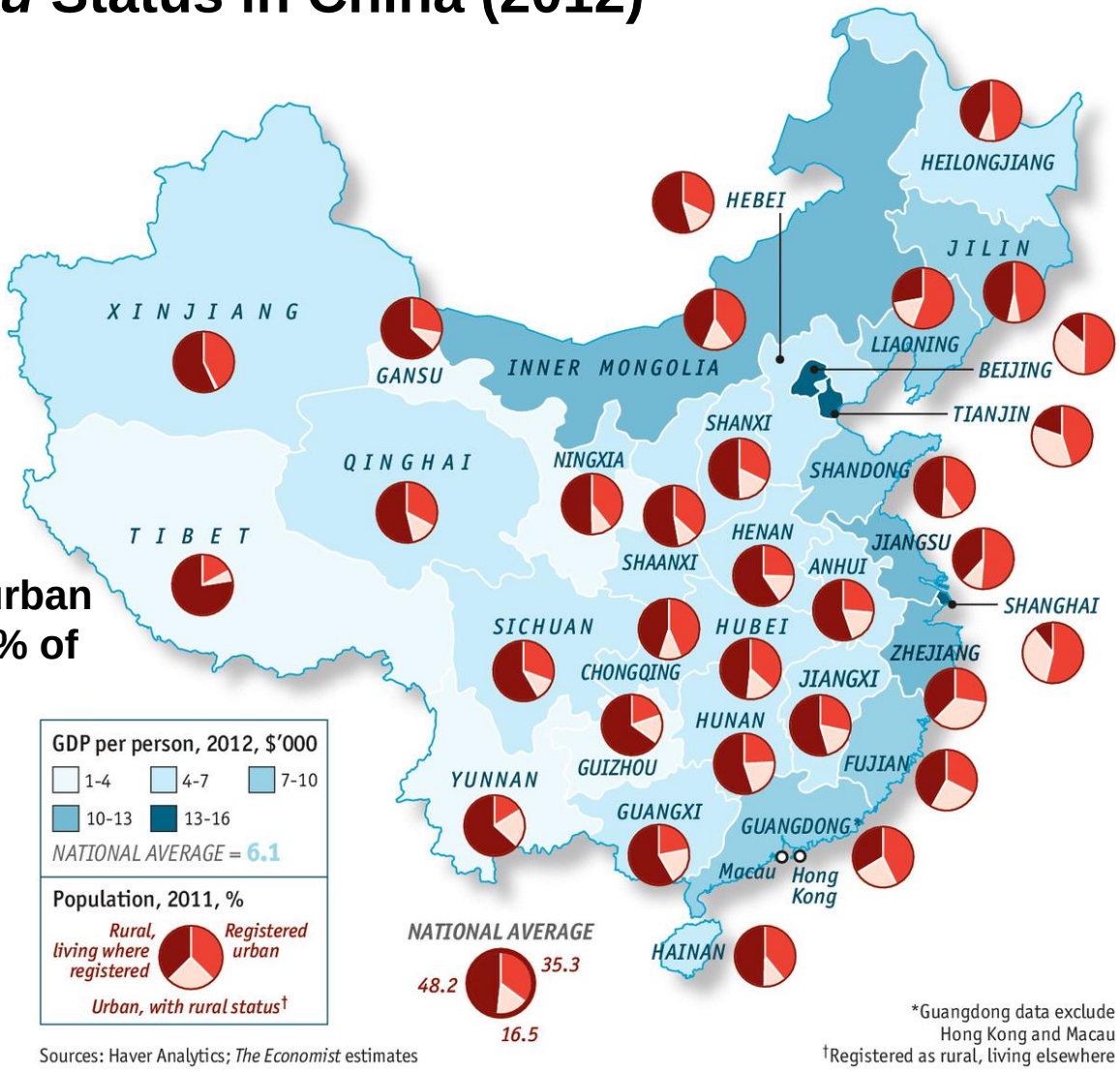
Source: Li et al., 2012

- **Overall trade balance a function of difference between domestic savings and investment**
- **Disparity between US and Chinese savings rates means US is a net debtor (trade deficit) and China a net creditor (trade surplus)**
- **US and Chinese contribution to global imbalances unlikely to change with appreciation of RMB**
- **As China's capital account becomes more porous, its ability to manage its exchange rate and target inflation will simply become unsustainable**

- **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**
  - **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**

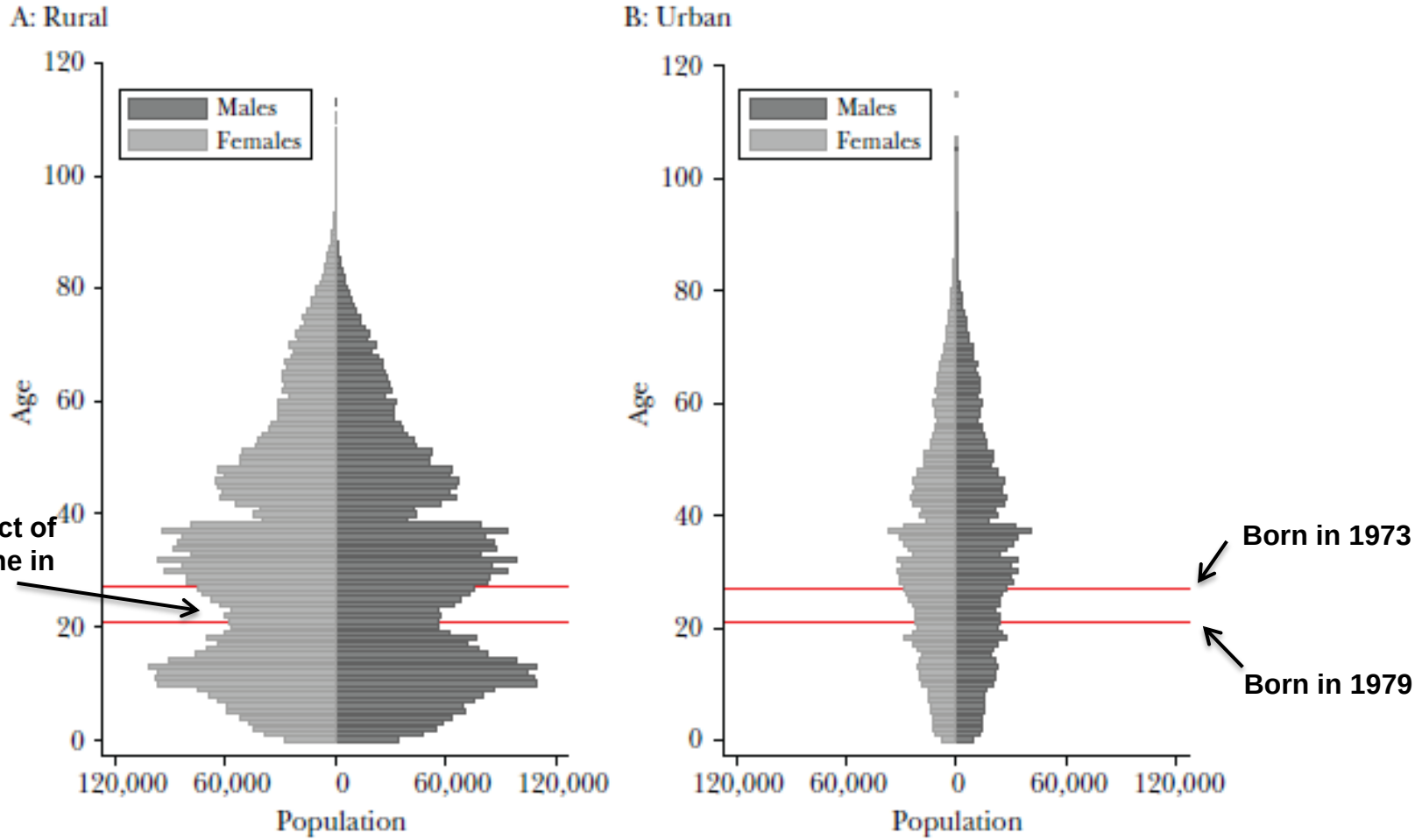
Hukou Status in China (2012)

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



- **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**
- **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**

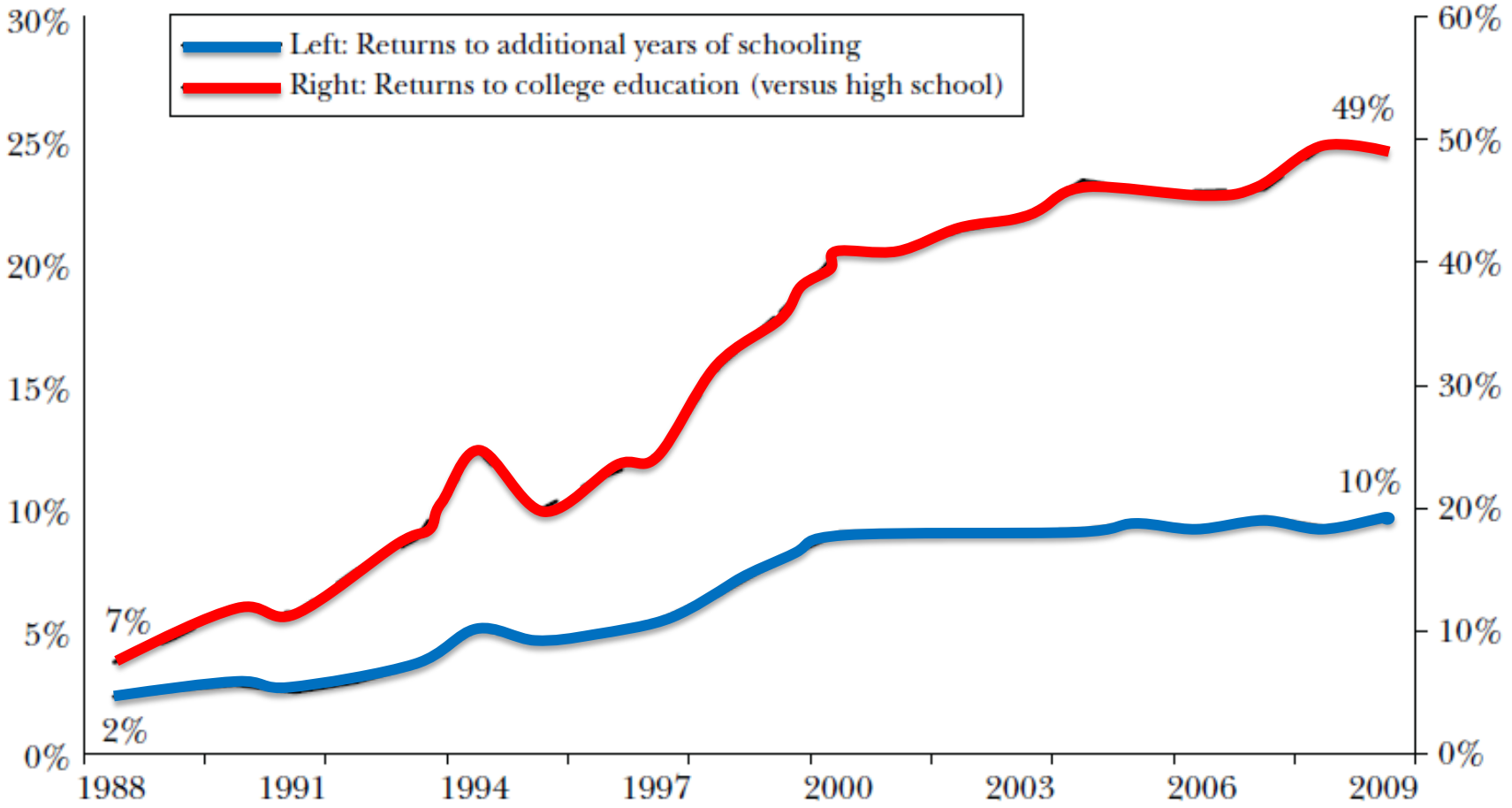
China's Population Pyramid (2000)



Source: Meng, 2012

- **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**
- **If productivity growth continues at this rate, China will switch to manufacturing more skill-intensive, and higher value-added goods**
- **However, growing divide between rural and urban education opportunities – university expansion having benefited urban areas much more**

Returns to Education in Urban China



Source: Li et al., 2012

- **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**