“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

- Toys/games
- Footwear
- Cell phones/TVs
- Computers

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
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)

“A: Rural

B: Urban

“Echo” effect of Great Famine in late-1950s

Born in 1973

Born in 1979

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