Asia Times Online

www.atimes.com

with: 亞洲時報在綫 www.asiatimes-chinese.com

China

Feb 26, 2004

Blaming 'undervalued' yuan wins votes

By Henry C K Liu

With the 2004 US presidential election drawing near, the trade deficit is again a campaign issue. Proponents of globalization have long argued that the US current account (trade) deficit is not a serious concern since it is being financed by a capital account surplus supplied by America's trading partners, providing ample debt financing for the dollar economy. Imports from low-wage countries have kept the dollar inflation rate low, with attendant benefits of low interest rates and high liquidity. For more than a decade, the loss of US blue-collar manufacturing jobs was accepted as what Federal Reserve Board chairman Alan Greenspan called "creative destruction", a distortion of Joseph A Schumpeter's concept of survival of the economically fittest through continuous innovation.

Notwithstanding that 2.1 million jobs have left the United States since President George W Bush took office in January 2001, the dollar economy has not lost manufacturing jobs; it merely relocated them overseas for more productivity per unit of investment. US transnational companies are still employing a growing global workforce for the benefit of US consumers through cross-border wage arbitrage and dollar hegemony, which permits a fiat currency of the world's most indebted nation to retain the privileged status of reserve currency.

Thus when US job growth slows, the stock market, which measures the global performance of companies, rises. US labor unions have watched helplessly the drastic drops in membership that translate into loss of political leverage in shaping US economic policy. Greenspan told Congress that "thinking" jobs are better than "doing" jobs. The United States will keep high-paying jobs in financial services, management, design, development, sales and distribution - and let the emerging economies have the low-paying assembly-line jobs in factories owned by US companies.

Even small business, a key component in job creation, is increasingly taking advantage of low-cost telecommunication and transportation to play the wage-arbitrage game through cross-border outsourcing. Now that the effects of cross-border wage arbitrage are hitting the high-tech sector, laying off highly paid US high-tech workers and giving their jobs to cheaper workers overseas, the political reverberations are louder. In this jobless recovery, these better-educated workers have the political clout to turn US policy toward protectionism.

The impossible dream: Bringing back low-wage jobs
Yet the structural characteristics of globalization make the prospect of bringing low-paying manufacturing jobs back to high-wage locations an impossible dream, unless US workers are prepared to work for below-living wages and US industries are prepared to live with the stricter US labor and environmental regulations. The dollar economy grows at the expense of US domestic employment. The high yields on workers' pension-fund investments are robbing the same workers of their jobs.

This structural crisis has been masked by the unprecedented expansion of US consumer debts, which now exceed US$9 trillion, or 90 percent of gross domestic product (GDP). This is collateralized by the wealth effect

Print article
Email article
Currency converter

RELATED ARTICLES

Floating the renminbi is a red herring

The Election Cycle Theory and the Fed
(Feb 24, '04)

China-US: Double bubbles in danger of colliding
(Jan 23, '04)

China-US trade: The game's afoot
(Oct 9, '03)

Politics, jobs and the yuan
(Sep 18, '03)

Converter

Book Reviews

of high returns on worker pension funds invested in the stock market and the inflated value of their homes. Total credit-market debt for all sectors is now 299 percent of GDP. In 1984, when consumer debt stood at only 50 percent of GDP, it drove the market three years later, in 1987, to a severe crash, which Greenspan bailed out with a flood of liquidity that released the biggest financial bubble in history - it burst first in Asia in 1997 and finally in the US in 2001.

Imports from low-wage countries such as China are resold in the United States at a greater profit margin for US importers than that enjoyed by Chinese exporters. Thus a $2 toy leaving a US-owned factory in China is a $3 shipment arriving at San Diego. By the time a US consumer buys it for $10 at Wal-Mart, the US economy registers $10 in final sales, less $3 import cost, for a $7 addition to the US GDP. This yields a ratio of GDP gain to import value of two-and-a-third.

Chinese GDP gain to export value ratio is zero if the $2 export price becomes part of the US capital account surplus. If half of the $2 export price is used for paying return to foreign capital, then the ratio is in fact negative. The numbers for other product types vary, but the pattern is similar. The $1.439 trillion of imports to the United States in 2002 were directly responsible for some $3.35 trillion of US GDP, almost 32 percent of its $10.45 trillion economy. That is why US policymakers have no incentive to reduce the trade deficit. But during a presidential campaign, blaming it on China's undervalued yuan gets votes.

In 2003, Chinese exports worldwide reached $430 billion, with imports of $410 billion, yielding a $20 billion surplus. The trade volume between China and the US hit a historic high of $126 billion in 2003. China has become America's third-largest trade partner. Chinese imports from the US reached $34 billion, while exports to the US exceeded $92 billion. China's worldwide trade surplus for 2003 was $25.5 billion, meaning that more than half of the surplus from the United States went to cover Chinese deficits with other trading partners.

Chinese consumers can't afford their own exports
Since Chinese export value constitutes only 20 percent of its final market price, economies that buy from China enjoy a greater GDP growth from trade ($2.15 trillion) than China does. Since China imports at full market price with little markup, China does not enjoy any GDP add-on from its imports. Fair trade between two economies with disparity in wages and living standards then requires a trade surplus for the less advanced economy.

If the $430 billion of Chinese worldwide exports were consumed domestically at their final market price, $2.15 trillion would be added to China's 2003 GDP of $1.41 trillion, more than doubling it. The higher the trade surplus in China's favor, meaning more goods and services leaving China than entering, the more serious is its adverse impact on China's GDP. Chinese consumers cannot afford the products they produce for export - not because Chinese workers are not productive, but because their wages are too low, which ironically does not make Chinese products as competitive overseas as can be because of high markup by foreign importers.

Greater profit margins enjoyed by the importing economy raise apparent productivity because sales per employee increase from the factory floor toward delivery to the consumer. Thus the productivity growth in the US has been achieved by having cheap labor doing the producing overseas. Also, the closer final assembly is to retail outlets, the higher its apparent productivity. Through proximity to customers, sellers can gain advantage in the assembly of imported major parts to respond to changing customer orders. Thus US assemblers who outsource their parts can win final sales away from offshore integrated manufacturers who make the same parts and assemble them abroad. Japanese car makers have learned this lesson and are now assembling parts made offshore in the US for the US market.

In the high-tech arena, time to market of design innovation is critical. By deferring cost through the use of employee stock options, a local in the importing country can use its high stock valuation driven by creative accounting, and low production costs and low currency valuation and interest rates in the exporter economy to raise low-cost funds globally to subsidize production costs of the final product further.

The content of the products will increasingly come from low-wage, low-margin exporting economies, and the outsourcing assembler's manufacturing involvement may be little beyond snapping outsourced parts in place, advertised ad nauseam as a US brand. Dell is a classic example, as is Disney's licensing empire of made-in-China toys.

Highly indebted emerging market economies, through the undervaluation of their currencies to subsidize exports, ironically make dollar debts more expensive to repay in local currency terms. The moderating impact on US price inflation also amplifies the upward trend of the trade-weighted dollar index despite persistent US expansion of dollar monetary aggregates, also known as money printing. Adjusting for this debt-driven increase in the value of the dollar, import volume into the US grew with the expansion of dollar monetary aggregates, around 15 percent annually for most of the 1990s. The US enjoyed a booming economy when the exchange value of the dollar was rising, at a time when interest rates in the US were higher than those in its creditor nations.

Rising US interest rates prolonged US boom

This led to the odd effect that rising US interest rates actually prolonged the boom in the United States rather than restrained it, because they caused massive inflows of liquidity into the US financial system, lowered import-price inflation, increased apparent productivity and prompted further spending by US consumers enriched by the wealth effect of rising equity and real-estate markets despite a slowing of wage increases.

This was precisely what Fed chairman Greenspan did in the 1990s in the name of preemptive measures against inflation. Dollar hegemony enabled the United States to print dollars to fight domestic inflation, causing a huge debt bubble with price deflation, pushing up equity prices, which is called growth, not inflation.

The transition to offshore production is the source of the productivity boom in the United States. While published government figures of the productivity index show a rise of nearly 70 percent since 1974, the actual rise is between zero and 10 percent in many sectors if the effect of imports is removed from the calculation. The lower values are consistent with the real-life experience of members of the blue-collar working class and the white-collar middle class who have to work longer hours to service their debts. Neither the recovery nor the recent correction of the exchange rate of the dollar will restore manufacturing jobs in the US, unless the US is prepared to see its GDP drop by 25 percent. This is why Gregory Mankiw, chairman of the White House Council of Economic Advisers, said last week that outsourcing is a plus for the economy in the long run.

Henry C K Liu *is chairman of the New York-based Liu Investment Group.*

(A shorter version of this article was published recently in the Hong Kong Standard in two parts.)