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Chinese manufacturing myths

by Guy de Jonquières

Amid all the squeals in Washington at the yawning US trade deficit with China, one strikes a specially resonant political chord: that unfair Chinese competition is annihilating US manufacturing industry and "stealing American jobs". The assertion is so common it has assumed the status of fact. Yet it is almost entirely false.

For a start, the bilateral imbalance may be overstated. After ironing out the wide discrepancies between both sides' data, Oxford Economics, a consultancy, finds China's share has hovered at about a fifth of the total US merchandise deficit since 1995. That suggests the former is as much a result as a cause of the latter's growth. Heaping all the blame on China would be off the mark, even if US manufacturing were dying.

But by most measures, it is in rude health. The US is still the top manufacturing nation, producing almost a quarter of global output, the same as in 1994, while Japan's share has shrunk. Adjusted to reflect steady falls in the prices of manufactures relative to other goods and services, US output has doubled since 1985 and its share of gross domestic product has changed little in half a century.

True, more output is from plants owned by non-US companies, some of which have displaced indigenous production. That may fuel popular perceptions of national decline, particularly because greenfield factories usually shun the old rust belt. But corporate nationality is irrelevant to overall economic welfare, except insofar as foreign-owned plants often out-perform locally owned ones.

What of China as "job thief"? US manufacturing employment is in long-term decline, just as it is in other rich countries. But that is chiefly because of impressive productivity gains. Had none occurred since 1970, almost 40 per cent of all US jobs would – in theory – be in manufacturing, three times today's level. But the comparison is meaningless because standing still would have consigned US manufacturers to competitive oblivion.

Of course, Chinese competition has claimed some US manufacturing jobs. But Oxford Economics puts the losses from 2000 to 2010 as low as 500,000 – no more than the US labour force sheds each week. Their disappearance is also partly a statistical illusion. Many manufacturing jobs are actually in services, such as finance and marketing, which yield far higher returns. As companies have disaggregated or outsourced operations, official employment data have re-allocated swaths of workers to the services sector.

If US manufacturing is stronger than many Americans believe, China poses a weaker challenge than is often supposed. Its output is still less than half that of the US – and many of its industries are suffering a severe profits squeeze. Indeed, to call China a manufacturing economy is something of a misnomer. In reality, it is the world's biggest final assembly shop, with minimal local value-added.

As a forthcoming report* by the Institute for International Economics and the Center for Strategic and International Studies points out, on average two-thirds of the value of Chinese products is imported – and much more in some industries. Furthermore, China's much-ballyhooed "high-tech" exports are a quirk of customs classification: most are low-margin electronics products, such as DVD players. According to Jonathan Woetzel of McKinsey, the management consultancy, China still lags far behind the US in precision engineering industries.

Many big-ticket Chinese exports are of things no longer made in the US or that have never been made there. A large renminbi revaluation would merely shift Chinese production to even lower-cost locations elsewhere. Increases in China's still low productivity levels will have a similar effect as higher wages make low-skilled, labour-intensive output increasingly uncompetitive.

At the same time, more sophisticated activities will spring up to replace it. That has already happened in steel, where China's capacity has exploded in the past few years. It will soon be repeated in the car industry as investment pours into local production of the lower-cost components China needs to export vehicles profitably in volume.

That is a prospect to strike fear into Detroit. But the main reason is not because Chinese car companies are likely to develop overnight into super-competitive Toyota clones. It is because decades of mismanagement and failure to produce what the market wants have pushed US carmakers to the edge of the abyss. It will not take much to tip them over.

Moving steadily up-market is a natural, indeed inevitable, feature of economic development. The biggest worry for the US – and other rich nations – is not that China will follow the same path but that their own economies will stop doing so. There is no intrinsic reason why that should happen and few signs of it as yet. But if it does happen, they will have only themselves to blame.

*China: The Balance Sheet www.iie.com