"China's Trade and U. S. Manufacturing Jobs"

N. Gregory Mankiw
Chairman of the Council of Economic Advisers

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Mr. Chairman, Ranking Member Rangel, and members of the Committee, thank you for the opportunity to testify on the important subject of the relationship between trade with China and the U.S. economy. I will also focus on recent developments in manufacturing and on the connection between these developments and trade with China.

To summarize quickly, trade with the world, and with China in particular, provides substantial benefits to the U.S. economy. It is important that China continues to take steps to strengthen our mutually beneficial trading relationship. For example, China needs to continue to open its markets to U.S. products and to safeguard U.S. intellectual property rights. These actions will further increase the mutual gains from our economic relationship with China.

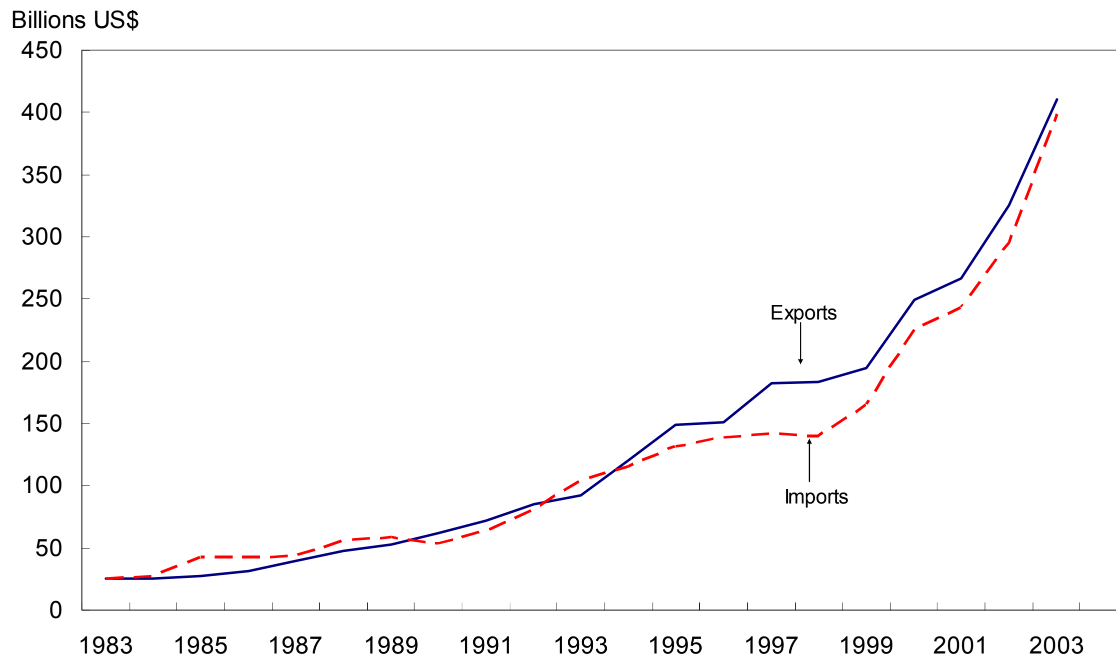
At the same time, the emerging importance of China in world trade has increased competitive pressure on some firms and industries in the United States. The Administration is committed to helping affected workers and their communities, including through enhanced trade adjustment assistance and personal reemployment accounts.

China's Trade with the World

China's emergence as a major participant in world trade is fairly recent. The volume of China's trade with the world was modest throughout the 1980's and early 1990's. Chinese imports and exports grew rapidly in the mid-1990's, however, and have increased even more dramatically since 2000. The level of Chinese imports and exports of goods has roughly doubled over the past five years.

The recent growth in China's trade has been fairly evenly divided between its growth in imports and exports (Chart 1). Although total Chinese exports have somewhat outpaced total imports since the early 1990's, this difference is small compared to the overall level of trade. Moreover, imports into China have recently increased slightly faster than Chinese exports, causing a reduction in its overall trade surplus.

Chart 1: China's Trade in Goods



Note: 2003 figures are through September annualized.

China's imports of goods are roughly one-quarter of GDP, well above the share for the United States and Japan (for which the comparable ratio is around 10 percent). China's increased demand for foreign manufactured goods and raw materials has been particularly dramatic. Chinese imports of both manufactured goods and raw materials have more than doubled over the past seven years. This increased demand has boosted exports and growth in many economies, especially in China's Asian neighbors and commodity exporters (such as Brazil and Chile).

The recent increase in Chinese imports has caused China to run trade deficits with many countries, including industrial countries such as Germany and Sweden. In fact, China's trade

deficits with most countries are so large that the country has had a trade deficit with the world excluding the United States for several years.

China still has much to do to open its markets to U.S. goods and services. Although it imports and trades relatively more (as compared to GDP) than some developed economies such as the United States, China is less open to the global economy when judged by other measures. In particular, China has much to do to ensure that it abides by its WTO commitments. This includes continuing to open its markets and respecting intellectual property rights. This also involves ensuring that imports and foreign firms can compete fairly with domestic products in the rapidly expanding Chinese market. Increased openness is good for both China and for the United States. For the same reasons that we benefit from trade and from openness to the world economy, so will China. Chinese consumers will have increased access to a variety of products from around the world. Lower import prices will make incomes go farther and raise standards of living. Imports will challenge Chinese firms to improve their competitiveness, leading to higher productivity and thus higher wages and incomes for workers. These benefits of trade apply for both the United States and our trading partners.

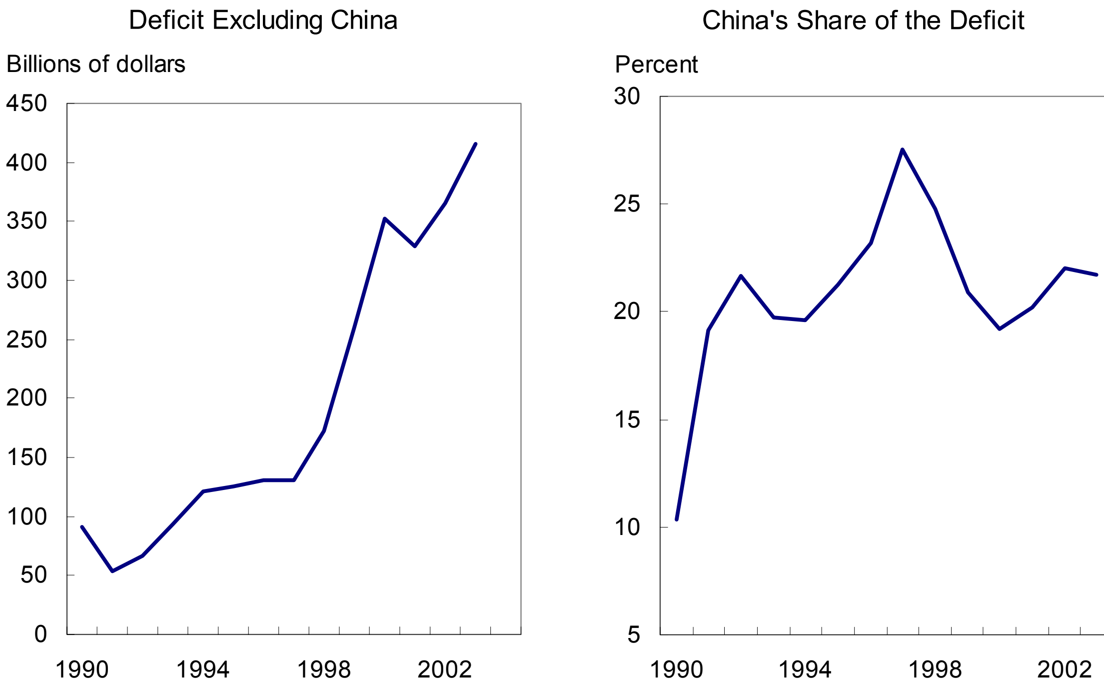
China's Trade with the United States

Trade linkages between the United States and China are substantial and important to both economies. The United States is China's most important export market and accounts for roughly one-quarter of all Chinese exports. U.S. purchases of Chinese goods have risen about 40 percent since 2000, reaching $152 billion (annualized) as of August. This year through August, China has been the second largest source of U.S. imports, after Canada but ahead of Mexico and Japan.

This growth in Chinese imports into the United States has resulted in imbalanced trade between the United States and China. The U.S. trade deficit with China in goods is large and more than doubled between 1995 and 2000. So far this year, the U.S. has a $125 billion (annualized) deficit with China, our single largest bilateral trade deficit.

It is important, however, to put this deficit with China into context. At the same time that the U.S. deficit with China increased, the overall U.S. trade deficit with all countries other than China also rose sharply (Chart 2). Our trade deficit with the world excluding China is almost four times greater than our deficit with China. In fact, China's contribution to the overall U.S. trade deficit has actually fallen slightly in recent years. China currently contributes about the same fraction of the overall U.S. trade deficit as it did about 10 years ago (Chart 2). Trade with China accounts for roughly one-fifth of the increase in the U.S. trade deficit since 1997—slightly less than the contributions from the Euro area or our partners in the North America Free Trade Agreement (NAFTA).

Chart 2: U.S. Trade Deficit in Goods

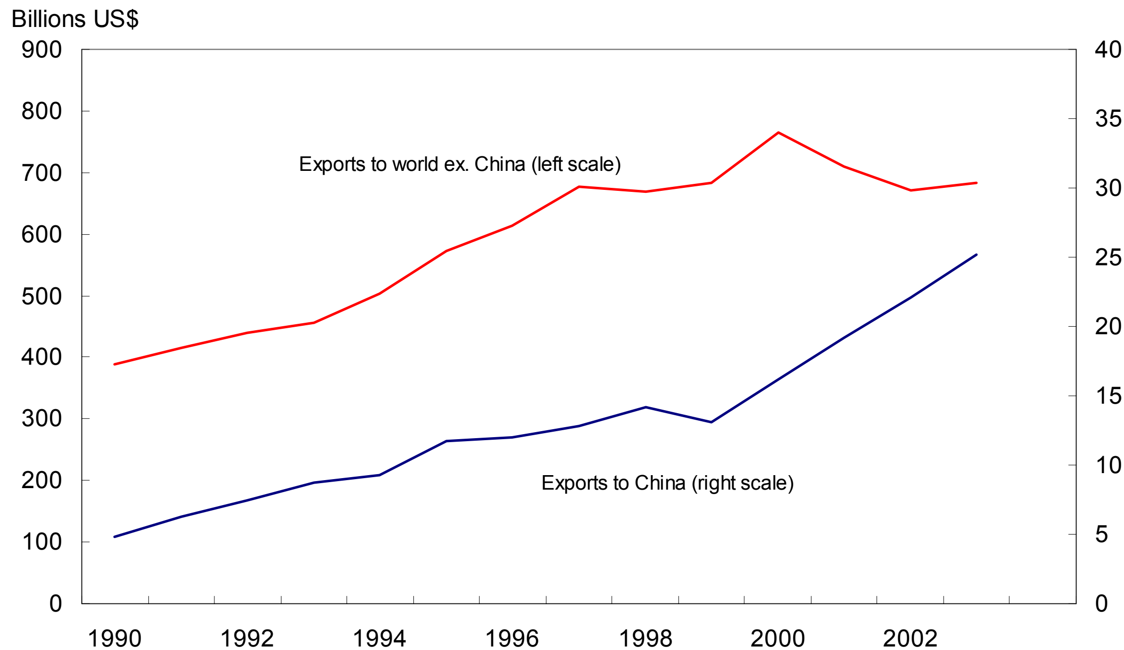


Note: 2003 figures are through August annualized.

Moreover, declining exports not rising imports account for the recent increase in the U.S. trade deficit. Over the past three years, U.S. manufacturing exports have fallen by about 10 percent, while imports have remained flat.

Without China, U.S. export growth would have been even slower. Although U.S. exports to the world excluding China have fallen since 2000, U.S. exports to China have grown rapidly over the same period (Chart 3). China was the seventh largest U.S. export market last year, ranking after South Korea and ahead of France, and is the six largest destination for our exports this year through August. Exports to China have risen over 55 percent since 2000, to $27 billion in 2003 (through August at an annual rate). Among the products that the United States exports to China are: $1 billion in oilseeds and grain (roughly 14 percent of all U.S. exports in this category), $1.3 billion in semiconductors and other electronic components, and $1.5 billion in transportation products (with statistics for this year through June).

Chart 3: U.S. Exports of Goods

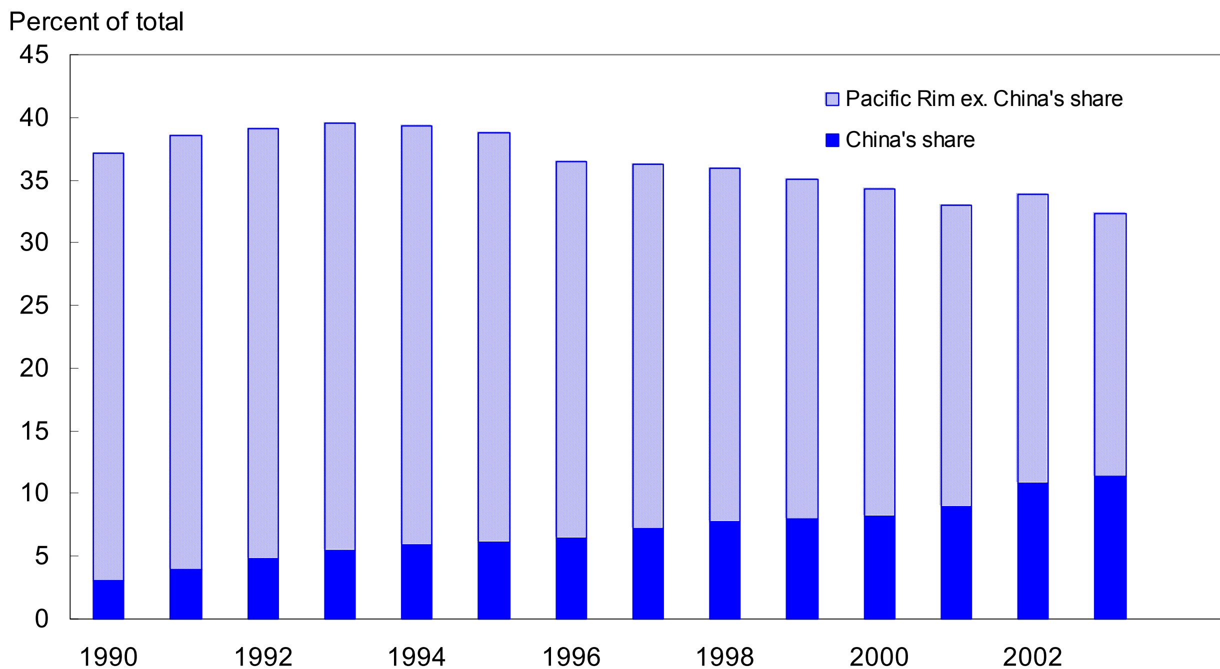


Note: 2003 figures are through August annualized.

Increased U.S. imports from China partially reflect decreased imports of the same goods from other countries, instead of a net increase in the U.S. trade deficit. In other words, our imports from China replace imports from other countries rather than add to total imports. This pattern is clear for many major products we import from China. In the textile and apparel industries, for example, China's increased share of U.S. imports since the mid-1990's has been more than offset by decreased imports from Hong Kong. For other products, including footwear,

toys and sporting goods, radios, and cameras, the increase in China's share of U.S. imports is roughly offset by a decline in imports from the rest of Asia. Indeed, although the share of U.S. goods' imports from China has increased since 1990, the total share from the Pacific Rim (including China) has actually fallen. This means that there has been an even greater decline in the share of U.S. imports from Pacific Rim countries other than China (Chart 4). That is, imports from China compete most directly with goods produced in other Asian countries.

Chart 4: U.S. Imports of Goods



Note: Pacific Rim countries are Australia, Brunei, China, Hong Kong, Indonesia, Japan, Korea, Macao, Malaysia, New Zealand, Papua New Guinea, Philippines, Singapore, and Taiwan. 2003 figures are through August annualized.

This is not to say that imports from China have no impact on firms in the United States. Chinese imports put pressure on firms competing with these imports and with the associated workers and communities. This is especially the case for firms that make items that are relatively intensive in the use of less-skilled labor, since these are goods in which China would be expected to have a comparative advantage. This advantage is reflected in the pattern of U.S. imports from China, which are mainly consumer goods—some 60 percent of the value of U.S. imports in 2003 through August—compared to only 28 percent capital goods imports. In contrast, U.S. exports to

China and to the world as a whole tend to be goods that are made by relatively high-skilled workers: 47 percent of U.S. exports to China are capital goods, 35 percent are industrial supplies, and 10 percent are foodstuffs (foods are produced using fewer workers per unit in the United States than in other countries). On the whole, this suggests that imports from China mainly compete with products from developing countries.

U.S. Manufacturing Employment and Trade

The challenges faced by manufacturing firms are related first and foremost to the recent business cycle downturn. For workers, this is compounded by a long-term trend of strong productivity growth in manufacturing that has meant that increased manufacturing output can be produced without concomitant growth in manufacturing employment. International trade would rank as a third influence—and trade with China would be one component of trade.

While the recent recession was the second mildest since 1960, as real gross domestic product fell by less than 1 percent in 2001 from its peak at the end of 2000, manufacturers felt the economic slowdown first, the most, and for the longest. Manufacturing production began to slow in early 2000 and peaked in June of that year. It fell by about 7-1/2 percent from June 2000 to December 2001 before it began to turn around. And while manufacturing production is now expanding, the number of workers is still shrinking.

A large part of the decline in manufacturing output stems from the nature of this recession. Unlike previous downturns in which household consumption and housing slipped, the weakness this time was felt mainly in business investment and exports. Both of these are particularly important for manufacturing.

The end of the high-tech stock market bubble and the corporate governance scandals of the past several years have particularly depressed business investment. This can be seen in the fact that the industries contributing most to the downturn in manufacturing are those primarily associated with the production of business capital goods. Computers and electronics, machinery,

and metals account for half of the swing in manufacturing production from its rapid growth of the late 1990s to its decline after mid-2000. Nearly all business equipment represents manufactured products. In contrast, household expenditure, which makes up around two-thirds of final demand, involves a mix of goods, services, and structures. Manufacturing was thus particularly hard hit as a result of the nature of this business cycle.

With industrial supplies and capital goods accounting for the bulk of U.S. nonagricultural goods exports, slow growth overseas and the resulting lackluster demand for U.S. exports has hit the manufacturing sector especially hard. Indeed, lower exports of manufactured goods can explain the entire decline in overall exports since 2000. While growth in the United States has not been satisfactory, we have outperformed many of our leading trading partners, notably Japan and major economies in Europe.

Looking back beyond the recent recession, the long-term downward trend in manufacturing employment primarily reflects relative gains in manufacturing productivity that have not been offset sufficiently by increased purchases of manufactured goods. Although manufacturing production more than doubled from 1970 to 2000, manufacturing employment fell from 25 percent to 13 percent of total employment, as a result of gains in productivity. Given the level of manufacturing output in 2000, had productivity remained at 1970 levels, the manufacturing sector would have gained importance, rising to 38 percent of total employment. On the other hand, had trade in manufactures been balanced since 1970, with productivity at current levels, the share of manufacturing employment would have fallen by nearly as much as it actually did.

Imports from China are one of many factors that influence manufacturing employment. The five industries that have contributed most significantly to manufacturing job losses since July 2000 are: computer and electronic equipment (16.0 percent of all manufacturing job losses), machinery (10.8 percent), transportation equipment (10.7 percent), fabricated metal products (10.7 percent), and semiconductor and electronic components (7.5 percent). These are export-intensive industries for the United States where imports from China are small. This suggests that

U.S. job losses are more closely related to declines in domestic investment and weak exports than to import competition.

The Outlook and Policy Responses

At the same time, it is important to recognize that trade can cause dislocation for some workers. The President has proposed a number of policies to help people affected by such economic changes. Notably, he has supported expanded trade adjustment assistance to help displaced workers gain or enhance job-related skills and find new jobs, including assistance with career counseling, training, income support during training, job search assistance, and relocation allowances. His innovative proposal for personal reemployment accounts will provide resources to workers most in need to help with the costs of training and adjustment. The proposed reemployment accounts would then offer a cash incentive for individuals to find work quickly, aligning public support with private incentives. The President has also worked with Congress to ensure that unemployment insurance benefits are available to people in need. These benefits provide important support for household incomes during difficult economic times.

There is a good deal of evidence that the economy is picking up momentum after three years of sub-par growth. Recent data suggest that conditions in the manufacturing sector may be starting to improve as well. Manufacturing production has edged up over the past several months. Shipments of capital goods rose strongly in the third quarter as a whole despite a small downtick in August, and orders remain above shipments, hinting at further growth ahead. The new orders index from the Institute of Supply Management's monthly survey of purchasing managers is now markedly above the level indicating expansion. Moreover, some of the factors that historically have affected firms' production decisions are supportive of a further firming in coming months—the cost of capital is extremely low by the standards of the last decade, and manufacturers' profits have risen substantially since the end of 2001.

Pro-growth tax policy has contributed greatly to the near-term recovery and to putting the economy on a better foundation for the future. Recent tax changes that give businesses greater incentive to invest will help many manufacturing firms, but the key is that the whole economy

will gain as these initiatives lower firms' cost of capital and spur investment. Higher investment today means that tomorrow's workers will have more capital to work with. This makes workers more productive so that they earn higher wages.

The President has outlined a six-point plan to maintain the economic recovery and to boost long-term growth. This includes making health care costs more affordable and predictable; reducing the burden of frivolous lawsuits on our economy; ensuring a reliable energy supply; streamlining regulations; opening new markets; and enabling families and businesses to plan for the future with confidence by making the tax cuts permanent.

The actions he has proposed will boost growth in general, but manufacturing will benefit directly as well. The appropriate goal for economic policy is to support growth and to raise living standards. This stronger growth is good for manufacturing as it is good for the entire economy.

Increased trade can further support higher growth. Trade is win-win, benefiting both the United States and all of our trading partners. More trade means more choices and lower prices for consumers, and bigger markets for firms—in both directions. There is work to be done on this front, notably to further open Chinese markets to U.S. products, and to ensure that China fulfills its commitments under the World Trade Organization agreements, including its commitment to safeguard U.S. intellectual property rights. As discussed by my colleagues on this panel, the Administration is actively engaged with the Chinese to address these important issues.

Conclusion

Thank you for the opportunity to testify. I look forward to your questions.