



The Asian Giants' Integration into the World Economy: What Does it Mean to the Poor (and the Rich)?

Keynote address at IIASA's 35th Anniversary
Conference on "Global Development: Science
and Policies for the Future" ,
Hofburg Imperial Palace, Vienna
14 and 15 November 2007

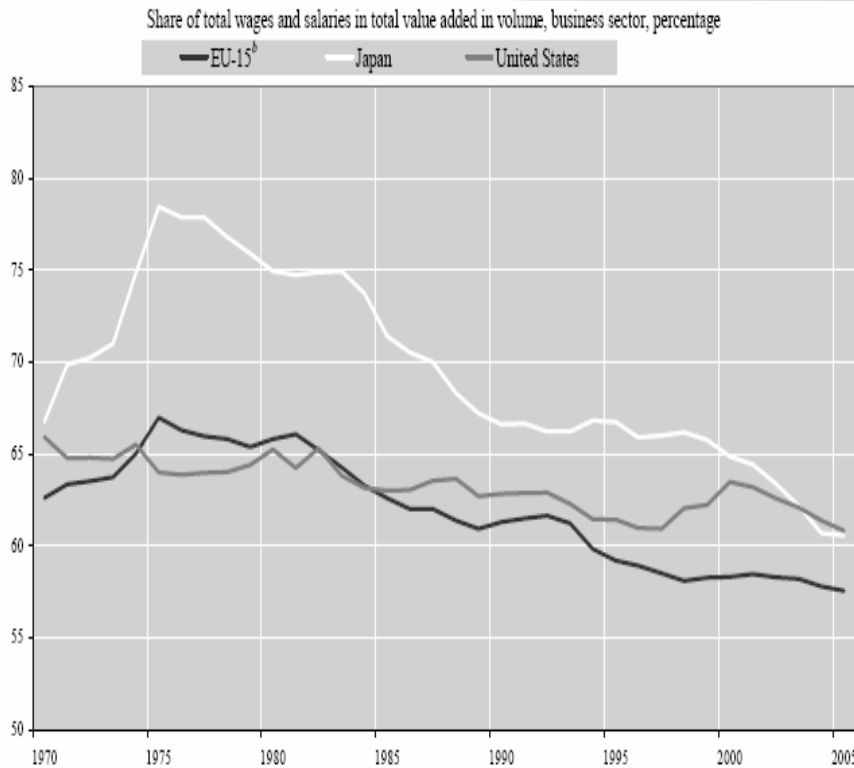
Prof.Dr. Helmut Reisen

OECD Development Centre



International Institute for Applied Systems Analysis
Schlossplatz 1, A-2361 Laxenburg, Austria
Tel: +43 2236 807 Fax: +43 2236 71313
www.iiasa.ac.at

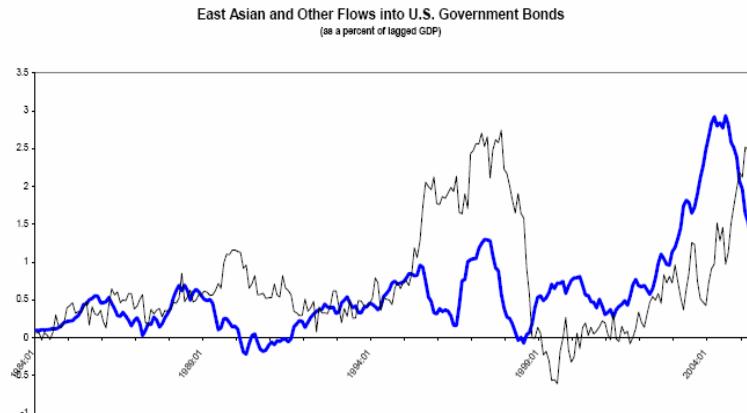
Wage share of national income *in EU-15, Japan and the United States, 1970-2005*



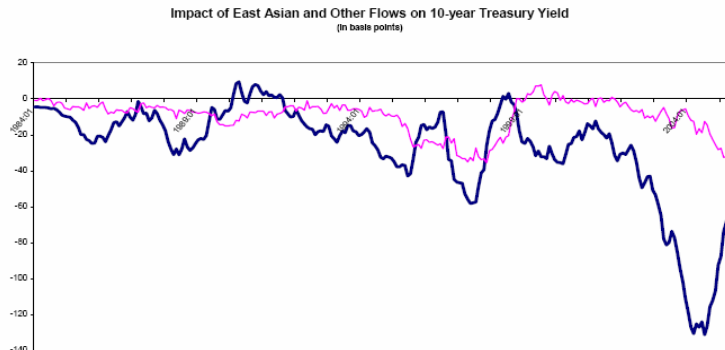
- Since the 1980s, the wage share in national income has been declining in OECD area.
- The wage elasticity of labour demand has increased, implying higher wage & employment volatility.
- This indicates eroding bargaining power of workers.
- Difficult to disentangle: effects due to globalisation in trade and outsourcing from other factors, such as factor-biased technical change, capital-deepening and changes in the industry mix of output.

The 'Asian Bid' has reduced global interest rates and stimulated asset price inflation.

(a) Flows decomposed into those originating from East Asia* (thick line) and elsewhere.

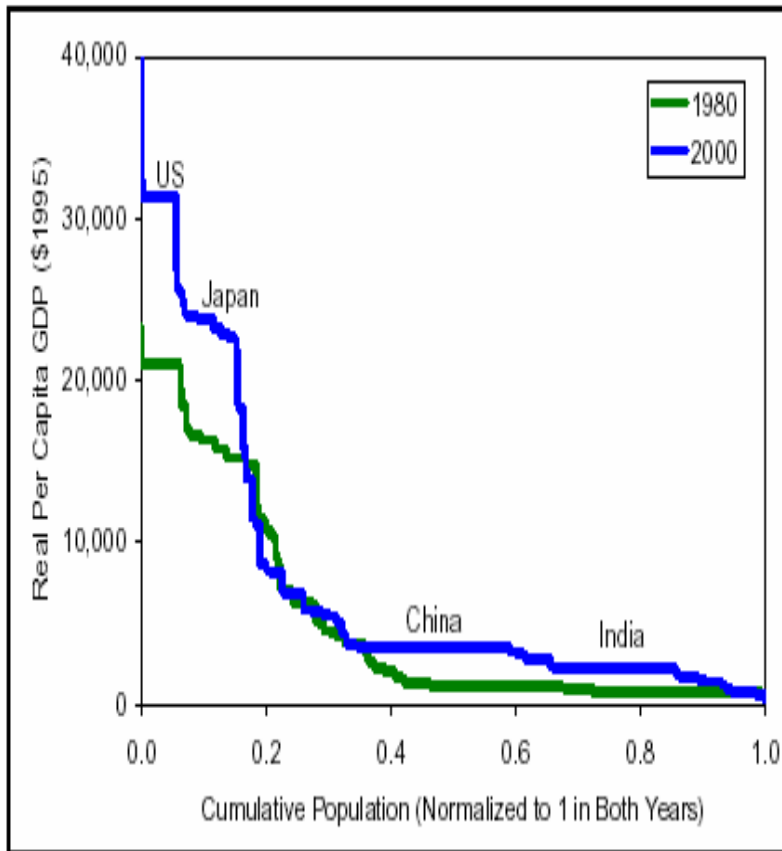


(b) Impact of East Asian* (thick line) and other inflows.



- The accumulation of reserves by East Asian countries has put downward pressure on U.S. long-term interest rates (up to 140 bp in 04)
- and caused some of the flattening of the U.S. yield curve (Source: Warnock).
- Liquidity creation and low rates have underpinned asset price inflation.

The global labour pool and real per capita incomes, 1980 and 2000

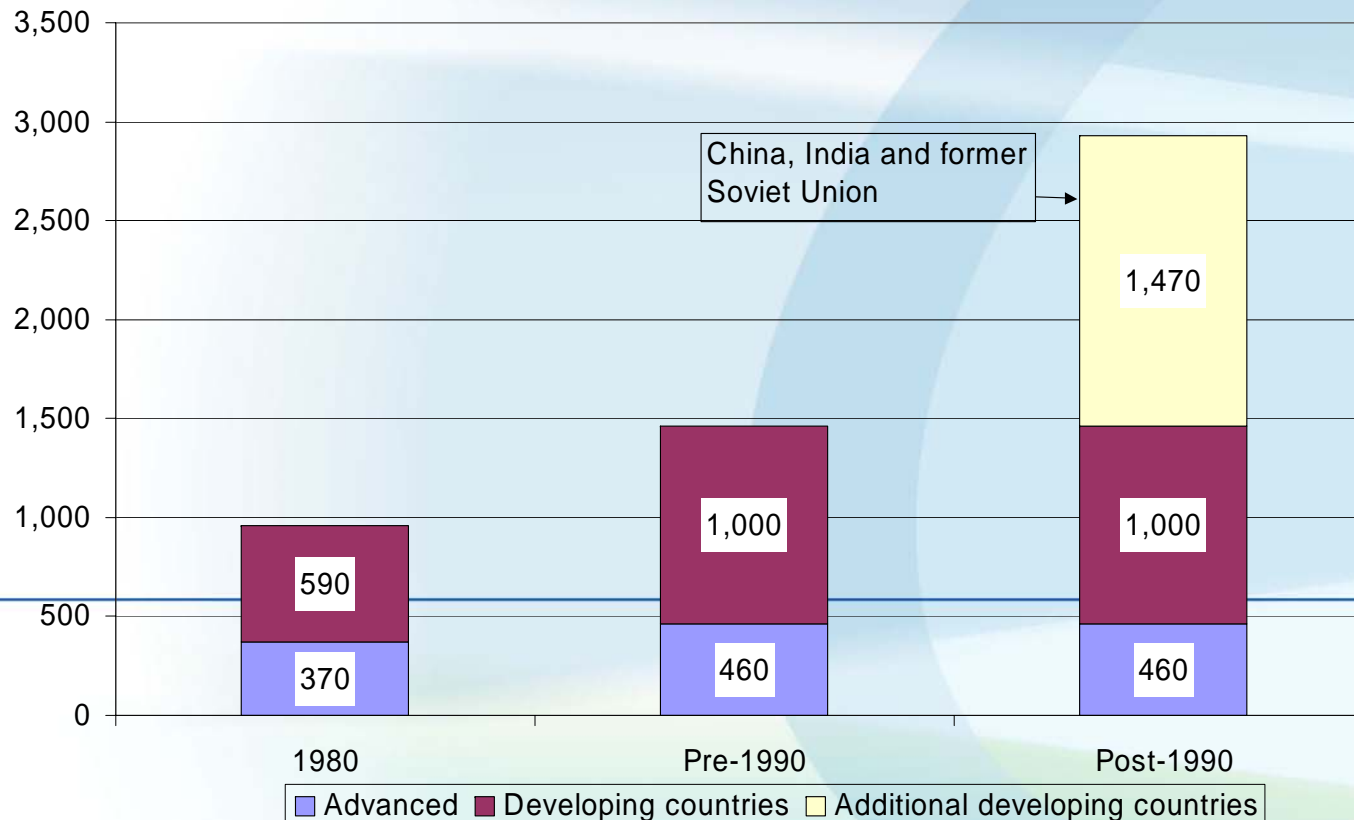


- **Country's share in world population (or labour force).**
- **China and India appear as a long line along the bottom.**
- **Wage and income convergence?**
- **=> Productivity?**

Underdiscussed: world labour markets - 2 bn people more in market economy

AUGMENTED GLOBAL LABOUR FORCE (m)

Source: Helmut Reisen





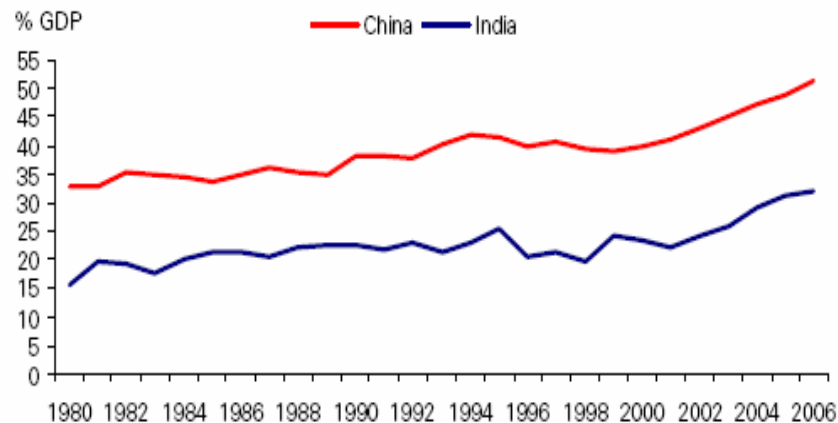
How much pressure has this placed on wages in advanced countries?

$Y = L^\alpha K^{(1-\alpha)}$, labour productivity is $Y/L = (K/L)^{(1-\alpha)}$. Write y for Y/L and k for K/L , then $\delta y/y = (1-\alpha) (\delta k/k)$; calibration yields $-0.15 = 0.3 (-0.5)$.

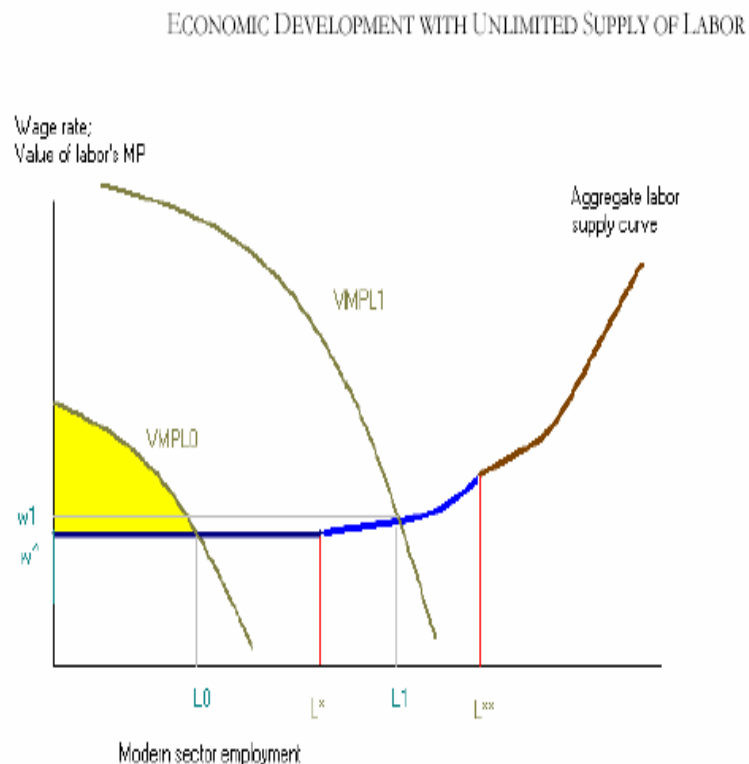
Multiplied with the initial shock to the capital-labour ratio, a back-of-the-envelope calculation suggests that the inclusion of the Asian giants and of the former Soviet block has reduced **OECD equilibrium wages** by ca. **15 percent**.

But both Asian giants save – a lot.

China & India: Savings Rates

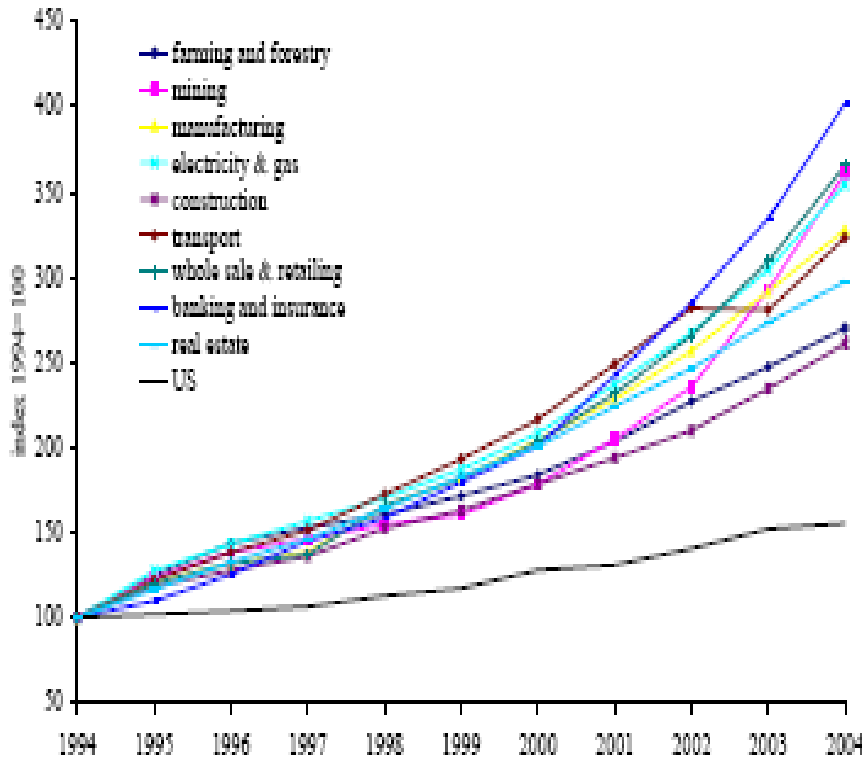


China's and India's Surplus Labour & the World Economy: 2000



- **Arthur Lewis:** supply of labour to the modern sector is perfectly elastic
- Wages just above the subsistence income level can attract an unlimited supply of labour into modern sector.
- We witness a move beyond L_1 since 2005.

China: Nominal Wage Increases across Different Sectors, 1994-2004



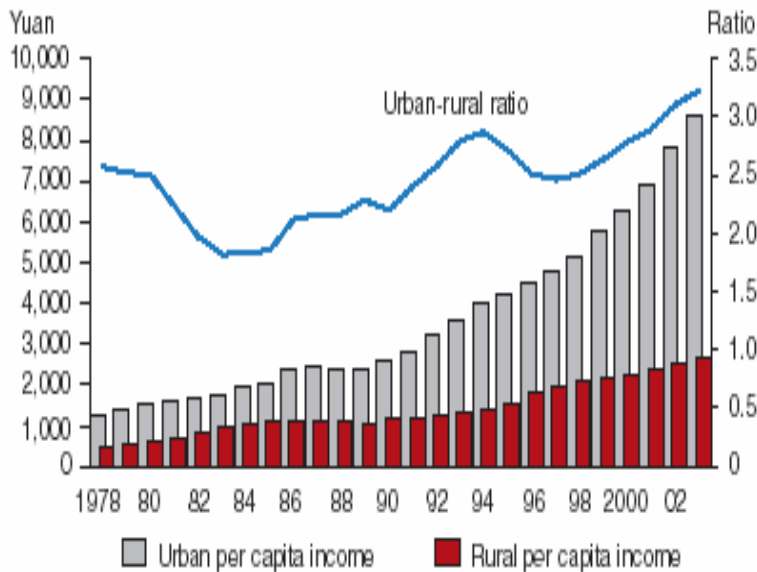
Rural migrants move to jobs in construction first. Over 1994-2004, nominal wages rose much faster than in the US.

But entry wages rose more slowly.

This helped keep wage-intensive goods prices lower.

China's urban/rural wage wedge

China's urban and rural real per capita income, 1978-2003



Note: Per capita income is deflated using the retail price index and expressed in year 2000 constant yuan.

Source: Calculated by ERS using data from China National Bureau of Statistics.

- **Until 2003, China was far away from reaching the point where wages would start to converge between the rural and the urban sector.**
- **In the quarter century from 1978-2003, urban per capita income has risen much faster than rural income.**

How Does Asian Wage Pressure Spill Abroad? **The Stolper-Samuelson Theorem**

- A drop in the price of wage-intensive products causes a reduction in the real-wage rate and an increase in the real return to capital in OECD.
- As long as the emergence of China and India did reduce relative prices of labour-intensive products in world markets, OECD equilibrium wages came under pressure.

How does Asian wage pressure spill abroad?

The Krugman/Lewis Model

- Competition will ensure that the ratio of the wage rate in the OECD area to that in China will equal the ratio of labour productivity in those sectors in which workers in the two regions compete head to head.
- Ex: Competing in intermediate tech, wages in OECD are 5 times higher

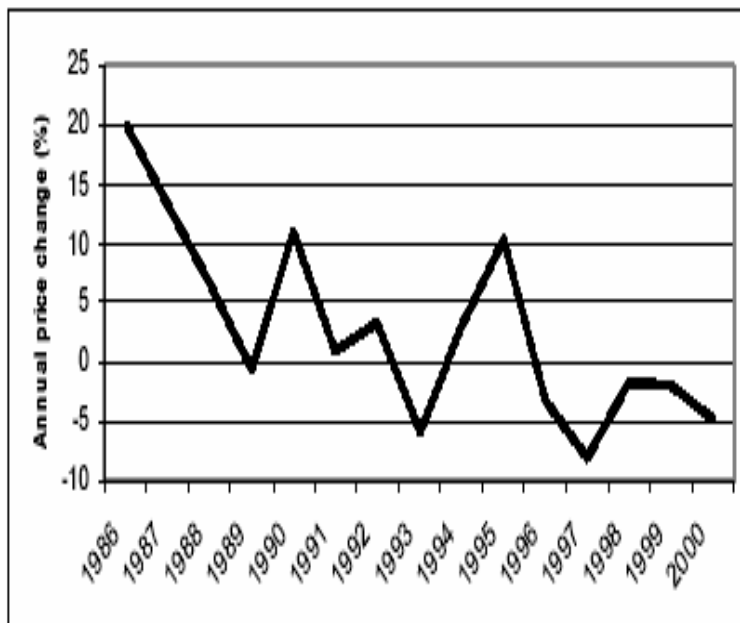
	Low Tech	Intermediate	High tech
Productivity OECD/Asian G	2/1	5/1	10/1
Labour Cost OECD/Asian G	5/2	1/1	1/2

Only under three conditions will higher labour productivity in China translate into higher low-tech prices and reduced purchasing power abroad:

- (i) productivity rises in the competitive medium-tech sector;**
- (ii) Chinese wages will rise accordingly as China has entered the phase where the labour supply curve starts to slope upwards; and**
- (iii) productivity has *not* risen in low-tech production, so that low-tech prices will rise as a result of higher labour unit cost. This potential adverse effect should show up in a rise of China's *terms of trade*, or the ratio of her export to import prices.**

We will see later that China's *terms of trade* have worsened until 2003, but since then are rising.

Up to 2003: Exporting Deflation & Purchasing Power



- The rapid export growth of low-skill and labour-intensive manufactures has increased the market competition for these goods and hence exerted a downward pressure on their prices.
- Falling (relative) prices raise the purchasing power of importers and consumers, in other words: their real wages; so surplus labour in China *benefited* in particular the low-income segments in the importing countries as low-tech products weigh relatively heavily in their consumption.

2000-2005: removing the impact of non-OECD growth on real **oil prices: - 40%**
 2000-2005: removing the impact of non-OECD growth on real **metals prices: -10%**

Figure 16a. Removing the impact of non-OECD growth on real oil prices

Percentage deviations from baseline

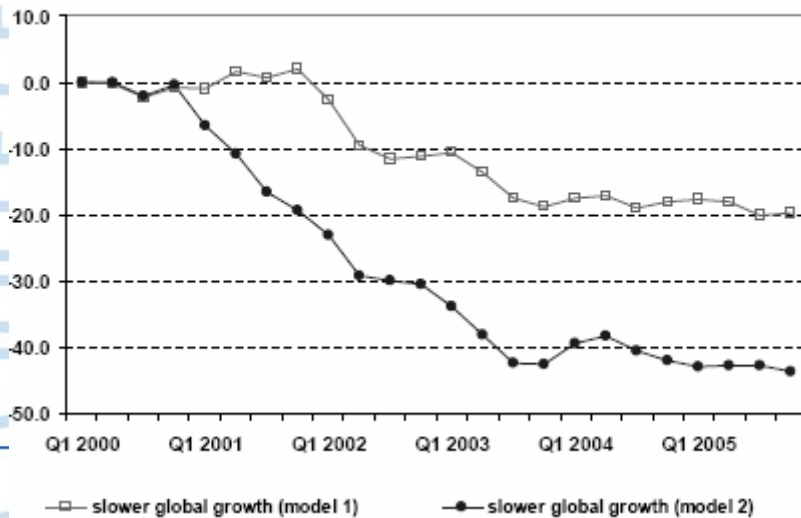
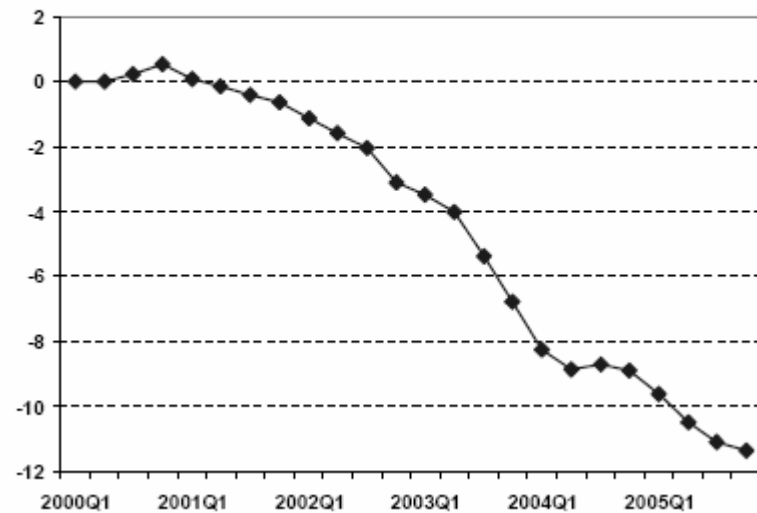
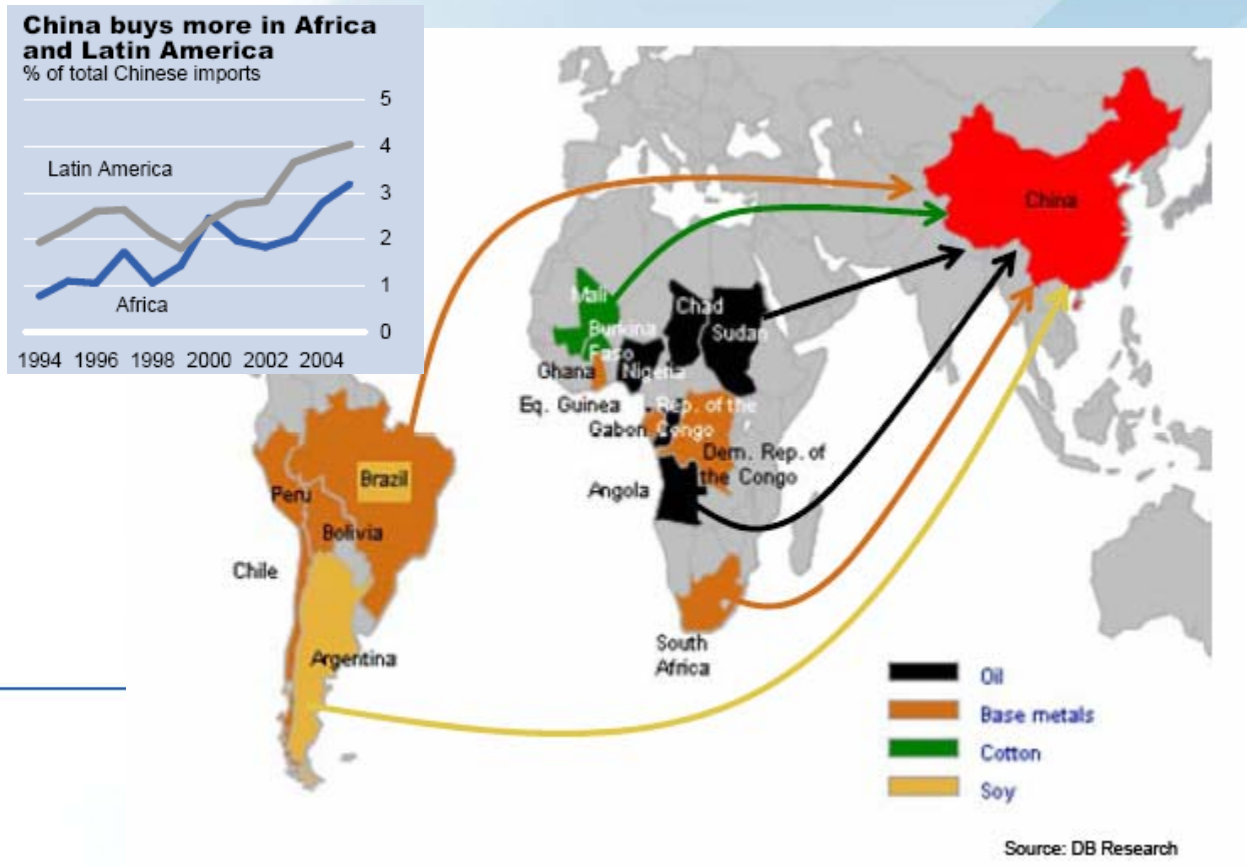


Figure 17a. Removing the impact of non-OECD growth on real metals prices

Percentage deviations from baseline

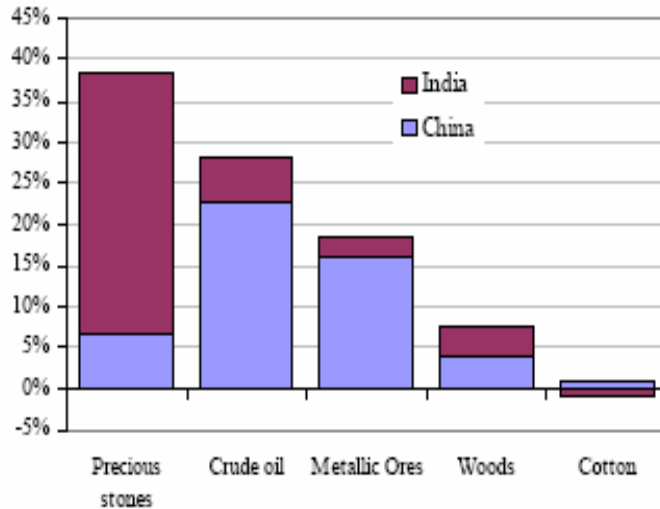


African and Latin American Commodity Exporters Benefit



Demand for oil and soft commodities reflects rising living standards

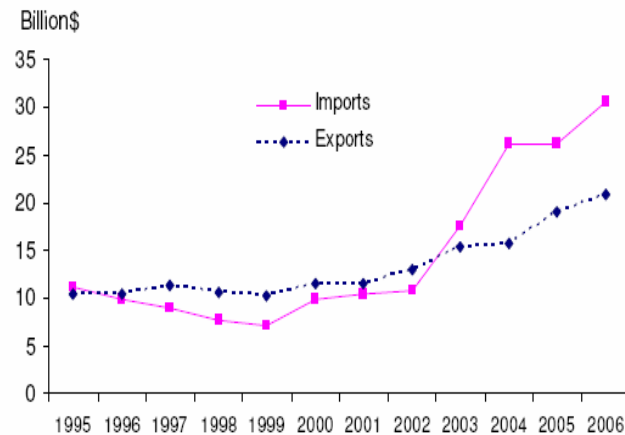
Percent contribution of China and India to the growth of world imports of selected commodities, 2000-2004



Source: Africa's Silk Road (2007)

HS codes	Commodity	Change, 2001-06 \$million	Share of change Percent
**	All agricultural	20,071	100.0
5201	Cotton	4,797	23.9
1201	Soybeans	4,680	23.3
4001	Natural rubber	2,438	12.1

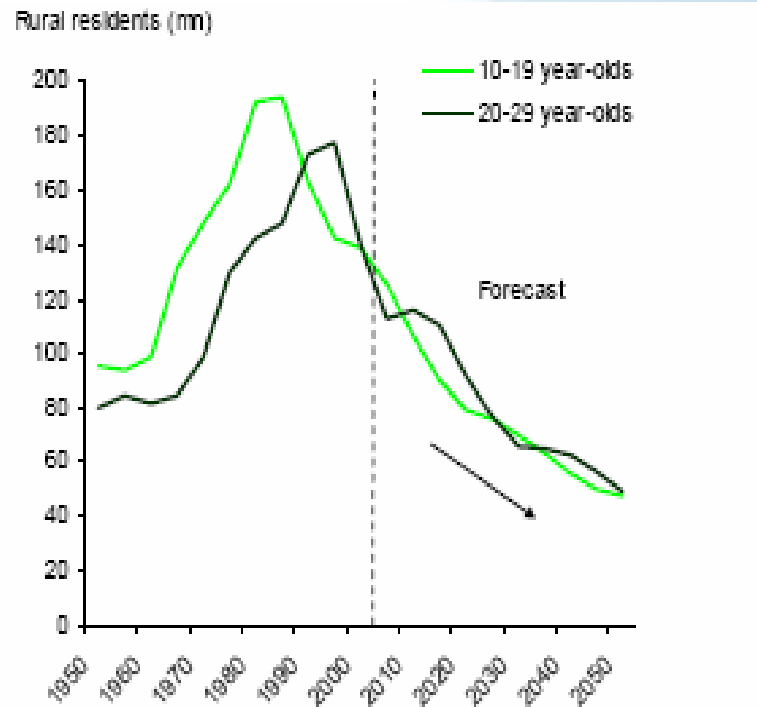
- Now: Rise of Agrar Imports



Note: Ddefinition of agricultural excludes fish and forest products and includes unprocessed cotton, w ool, and animal hides.

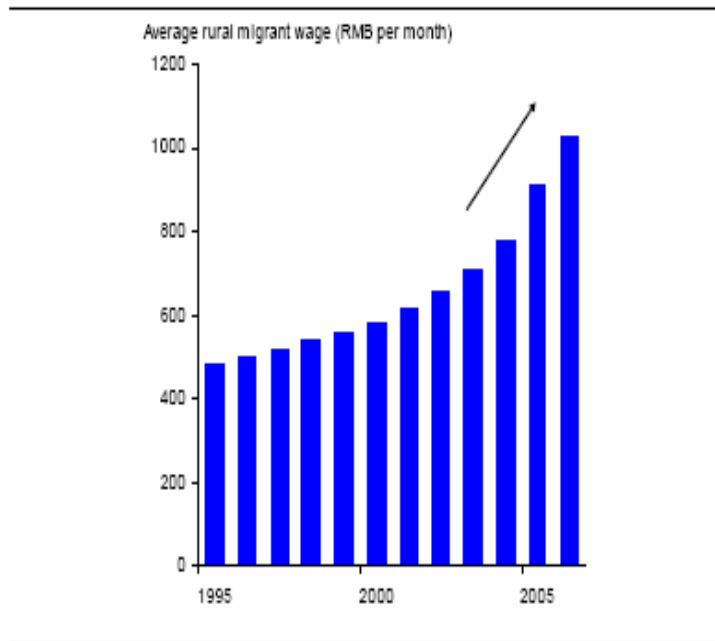
Source: ERS calculations using China Customs Statistics.

China: The Days of Flat Migrant Wages Are Over



- With a total rural working age population of 450 million and far fewer actual farmers needed to support China's agricultural output, most analysts put the number of underemployed rural resources at 250 million .
- With an estimated 120 million migrants employed in urban sector, it is doubtful that the Chinese export sector could grow by 20% to 30% per year on essentially flat wages.
- The supply of working-age young people has already dropped to under 120 million, with a similar trend for the upcoming 10-19 year old cohort.
- And food prices are rising quickly, hence rural incomes.

China's urban/rural wage wedge

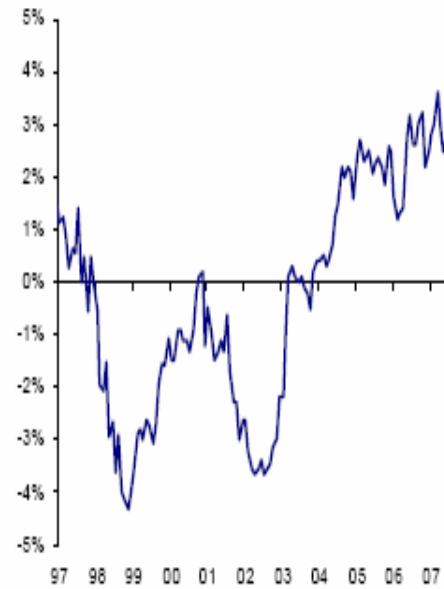


Source: CEIC, UBS estimates

- **Since 2004, avg. migrant rural wages have started to rise faster than before**
- **Migrant workers saw a greater increase in the past three years than they did in the entire previous decade, and that wages are now rising at more than 12% per year.**

China's Export Inflation

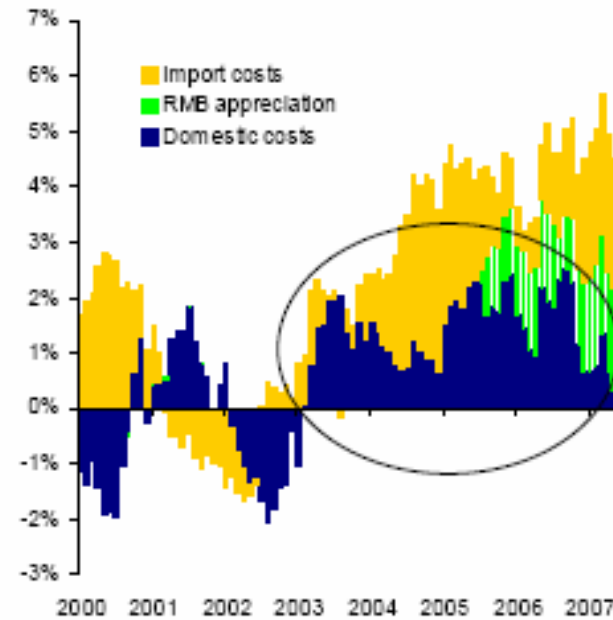
Price growth, Imports from China (% yy)



Source: CEIC, UBS estimates

- **China's export inflation has swung around by 6% since 2004,**
- **From -3% y/y to +3% y/y**

Contribution to net change in USD export inflation (% yy)



Outlook: At the start of a new era?

- SWFs instead of US bonds; yuan up $\Rightarrow r^*$ up
- Asset price inflation dampened
- But goods price and wage inflation:
- Higher prices for skills and soft commodities
- Low-skill goods and wages will rise as well
- Erosion of purchasing power, however
- **Σ : Changed distributional impact of Asian Giants**