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US economic decline impacts China trade policies

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The economic turbulence in the United States economy and the depreciating US dollar are impacting bilateral trade with China, but there are policy changes, too. The central government of China is taking measures to ease the trade surplus with the US and more evenly spread development in China to cause fewer exports and more imports. The policy changes result in displacement of labor-intensive processing companies as costs increase for factory owners in both the Pearl River Delta of the south and the Yangzte River Delta of the east.

"The slowing US consumer spending has not affected Chinese exports to the US, yet, in the general picture, but we see it probably in the third quarter of 2008," said a manufacturer of consumer products near Shanghai in a recent interview with the *American Journal of Transportation*. However, already there are indications of fewer exports to the US and a trend towards more imports to China. The goods deficit with China decreased from $25.9 billion in October to $24.0 billion in November, 2007 with imports to the US dropping $1.8 billion (primarily, apparel, household goods, toys, games and sporting goods) during the period, according to the US Census Bureau, Foreign Trade Statistics. In January, 2008, imported full twenty equivalent unit containers (teus) at the Port of Long Beach, the second busiest port in the US, decreased 13.8% from January, 2007 and exports jumped 12.4% from the same period. Similarly, the Port of Oakland saw a drop in imports by 1.1% and an increase in exports by 8.6% for the year ending 2007 over 2006.

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There is lower consumer spending from the credit crisis brought about by the home mortgage problems, but the Chinese central government is adjusting foreign trade policies. The goal is to reduce exports and rely more on consumer demand for growth in the gross domestic product than investments and exports. "Since 2006, there was vicious price competition among Chinese manufacturers in exporting and dumping to the US market of low quality products," said the manufacturer near Shanghai.

The first measure was in September, 2006 by the Ministry of Finance in a *Circular Concerning Adjustment to Tax Rebate Rates for Certain Exports and Additions to the Catalogue of Prohibited Products for Processing Trade*. The adjustment to export tax rebates affects 2,831 products, or 37% of the total items on the China Customs nomenclature. There are lower tax rebates to exporters of textiles and plastics from 13% to 11%. Total consumer products affected are 2,268 from luggage, apparel, toys and shoes to furniture and sewing machines. The measure went into effect July 1, 2007 with the purpose to, "…further curb excessive export growth and mitigate problems arising from excessive trade surplus," according to a Hong Kong Trade Development Council (HKTDC) website report.

The report emphasized that China's textile industry, "…will bear the brunt of this change and the scope of employment affected will be great." The impact on the US textile market will also be felt. "China's share of 25 apparel categories increased from 10% in 2001 to a 72% share of the US import market in 2005," based on an on-line report by Edward Teague from Department of Commerce figures.

A second policy to reduce export growth, outlined on the HKTDC website, is Announcement No. 44 issued from the Ministry of Commerce (MOFCOM). Effective August 23, 2007, 1,800 items listed in the new Catalogue of Products under the Restricted Category in Processing Trade are subject to "actual payment" of Customs duty deposit. In particular, consumer products such as the textile processing enterprises will be affected up and down the supply chain. Deposit money will be held by Customs for one year with the deposit plus interest paid back. Textiles, garment and footwear industries will have to pay about $7 billion in Customs duty deposits, stated the report. The Pearl River Delta (PRD) region is more severely affected with a greater dependence on processing trade than the Yangtze River Delta (YRD) which is more diversified with heavy industry businesses.

Recent labor laws are another impact on export oriented industries. "It increases production costs very much and made their products less competitive compared to India and Vietnam. Salary increases were over 13% for last year in cities like Shanghai and Ningbo and the same is expected for 2008 and 2009. Not only the salary, but social welfare, retirement funds, housing and others to about an extra 40% of salary must be paid by business owners for each staff contract," said the manufacturer near Shanghai. These added costs from the labor laws will add over one dollar to the cost of a pair of shoes and potentially, cause thousands of factories to close or move, according to a recent *South China Morning Post*, Hong Kong report.

The intent of the government's trade policies is to slow the growth of exporting enterprises, decrease the trade surplus with the US and draw factories to the inland regions. The processing trade enterprises are finding incentives and foreign investment north of the PRD in Hunan and Jiangxi provinces as well as in the northeast in the Bohai Rim and in central and western regions. Guangdong eastern cities are building industry reloca-

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tion parks in cities of Huizhou and Heyuan. These new parks are being developed by Shenzhen, after their 20 years of 39.4% average annual industrial growth and saturation in processing labor-intensive enterprises.

The strengthening of the Chinese yuan, or renminbi (RMB), and the depreciation of the US dollar is having an impact on slowing China exports to reduce the trade surplus and stimulate China's consumer demand for US exports. "We also expect more import from the US to China due to the strong RMB and increasing domestic demands, especially food in China," said Ken Hui, CEO, Fans Trans International, Ltd. in Hong Kong, a global logistics service provider. He added that freight charges from China to the US will drop and charges from the US to China will increase.

The Yuan's value increased 12% against the US dollar since July, 2005 when the central government began to let the Yuan rise. There is debate on the impact of the yuan's rise to offset the growing trade surplus with the US and to where the value of the RMB is heading. Currently, the yuan is about 7.1 to the US dollar and the government may hold the rise to 7.0 for the sake of exports that needs to be balanced against the inflated food prices and further appreciation. The general consensus among Hong Kong analysts is an appreciation to 6.80 by the end of 2008 from a gain of 1.5% so far this year with some estimates as high as 10% based on South China Morning Post reports.

The prosperity of urban and rural residents is creating more disposable income coupled with the appreciating RMB for greater consumer demand for imports. Consumer spending increased 16.8% to $1.25 trillion (8.92 trillion yuan) and contributed the largest percent of China's gross domestic product (GDP) by 4.4% of the 11.4% (2007) total. Investments accounted for 4.3% and net exports, 2.7% of the total GDP, according to the National Bureau of Statistics in a recent HKTDC on-line report. In fact, retail sales are growing from annual disposable income in the cities, rising 12.2% to $1,941 and in the rural areas by 9.5% to $530. Moreover, there is a new policy debated on whether to change the three golden week national holidays of Spring Festival (early year), May 1st (Labor Day) and October 1st (National Day) to the American style long weekends spread through the year for more shopping opportunities.

Overall, the US economy with GDP per capita of $46,000 of $13.75 trillion GDP in 2007 is expected to continue to grow at a low annual rate from the recent .6% in the fourth quarter of 2007 to .5% in the first quarter of 2008, according to official US reports. As a result, forecasts for China's growth in its $2.5 trillion (2006) GDP economy are adjusted lower to 9.6% in 2008 from 10.8% based on the World Bank, China Quarterly Update. Similarly, the Asian Development Bank lowered estimates for China's economy to grow at 9.8% in 2008, largely because of the US slowdown on imports of consumer goods from China.

The Chinese government's currency and export trade adjustment policies are contributing to balancing the wide trade surplus with the US and spreading development to inland areas for processing industries as costs for PRD and YRD enterprises increase. "In general, I would say that the slowing US economy is not the key issue ahead for Chinese manufacturers, but Chinese labor costs, labor laws and the stronger RMB will make 40%-50% of them either close their factories or move away for survival," said the manufacturer of consumer products near Shanghai.