

# China/U.S. Labor Markets: Interdependencies at Work

## Global Interdependence Center 2010 International Conference Series

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Together we'll go far



- He who asks a question is a fool for five minutes; he who does not ask a question is a fool forever
  - Chinese proverb
  
- Comment with Context
  - Economics—not politics
  
- Interdependence
  - Markets + Countries

- **Aggregate Demand**
  - **Tradable goods**  
Fairly free trade of goods  
Consumer non-durables
  - **Non-tradable goods**  
Housing and healthcare, for example
  - **Tradable goods prices respond to impact of supply and demand**
- **Aggregate Supply**
  - **Cobb-Douglas production function with constant level of capital stock**

- Credit demand: U.S.
- Credit supply: global savings glut
- Interest rates
  - Global capital markets, not domestic
- Short rates trade off the funds rate
  - Set up carry trade
- Long rates reflect relative preferences
  - Corporate bonds
  - Agency bonds
  - Treasuries
    - Flight to safety today: recession
    - Flight to safety in the future: dollar depreciation, inflation
- Incentives
  - Interdependence of exchange, credit incentives

- **Supply**
- **Demand: Asia post-1997/98**
- **Large foreign exchange reserves—held in dollars**
- **HK and Yuan both effectively pegged to the dollar**

## A Closed Economy View—U.S./China in the 1970s/1980s

- Aggregate demand for labor, derived demand
- Aggregate supply of labor—positively related to real wage rate
- Labor demand, labor supply – nominal wages adjust
- Steady state—real wage rate, aggregate output and labor utilization affected by productivity and labor supply
- Increase in goods demand leads to direct increase in labor demand

## An Open Economy View—U.S./China in the 2000s

- Migration effects, 19<sup>th</sup> century model
- Returns to labor differ persistently, despite tendency for international trade to bring about equalization of factor prices
- Complete specialization prevented by decreasing returns
- Different goods require different factor endowments and different countries have different factor endowments
- Labor migrates to equalize factor prices

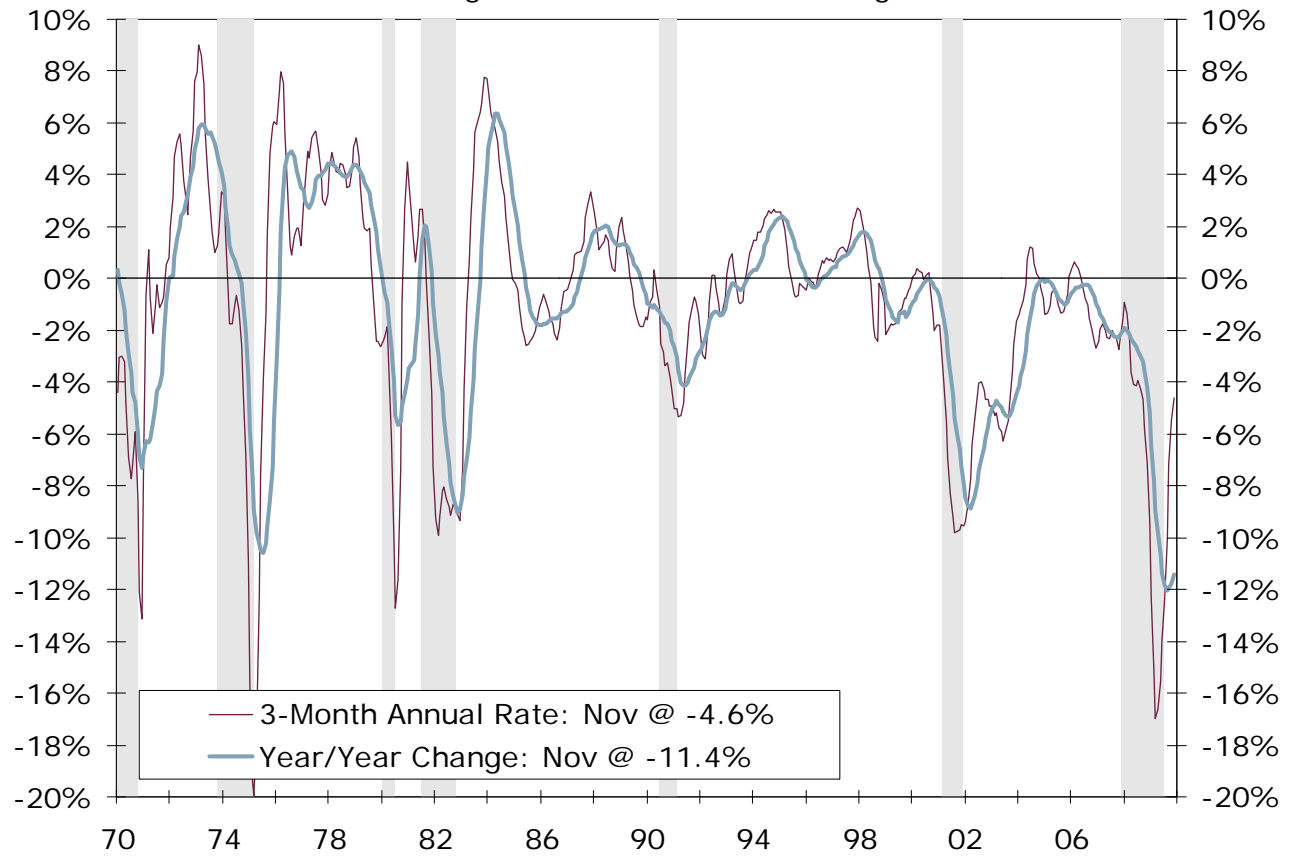
- Law of comparative costs: 21<sup>st</sup> century model
  - A country exports products which are comparatively cheap in price at home and imports those which are comparatively expensive
    - Lots of land relative to labor: produce wheat, e.g. Australia and Canada
    - Lots of labor relative to land: produce textiles, e.g. India, Hong Kong and China
- Trade in goods offers an alternative to factor mobility: domestic country can export labor and import capital by exporting labor-intensive goods and importing capital-intensive goods
- Assumption—each country has the same technological possibilities of producing a given good, i.e. production functions are the same
  - U.S. is capital-rich and therefore exports capital intensive goods
  - China is labor-rich and exports labor-intensive products

- The export of products of the abundant factor increases the demand for that factor and makes it more expensive. For example, excess demand for Chinese labor is not as cheap as years ago
- Import of products embodying large amounts of scarce factors makes those factors less scarce in the domestic market—excess supply of labor in the U.S. market
- Exports raise prices of cheap factor in China (labor)
- Imports reduce return to scarce factor in US (labor)
- Between continents, returns to labor differ persistently, although there is a tendency to bring about some equalization of factor prices

- Once on a tiger's back, it is hard to alight. –Chinese proverb
- Exchange rate and interest rate markets do not move the equilibrium
- Persistent excess supply of credit
- Persistent excess demand for Yuan, excess supply of dollars
- Persistent excess demand for goods in the U.S.
- Result in pressure on labor markets to adjust
- Persistent excess demand for goods
  - No political tolerance for high unemployment, empty houses

## US Manufacturing Employment Growth

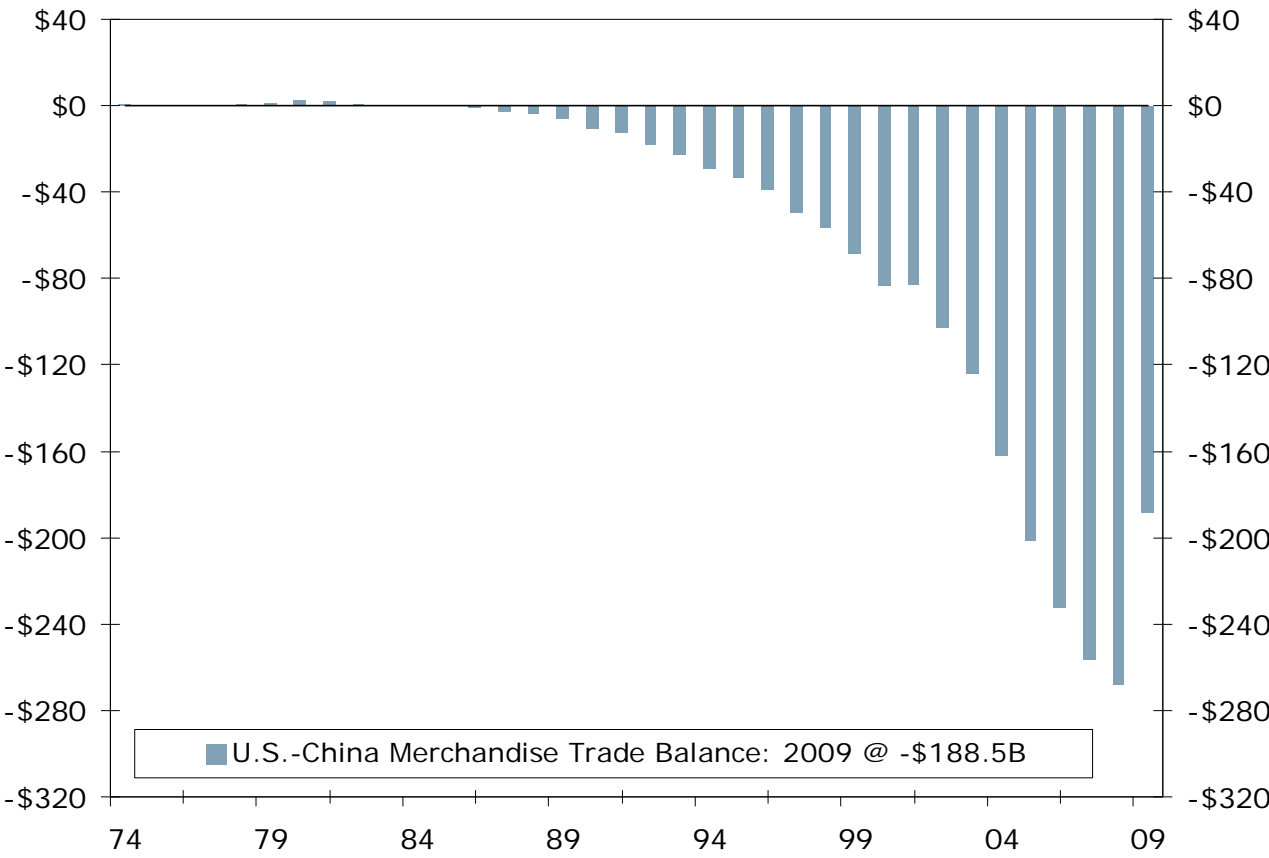
Yr/Yr Percent Change vs. 3 Month Percent Change, Annual Rate



Source: U.S. Department of Labor and Wells Fargo Securities, LLC

## U.S.-China Merchandise Trade Balance

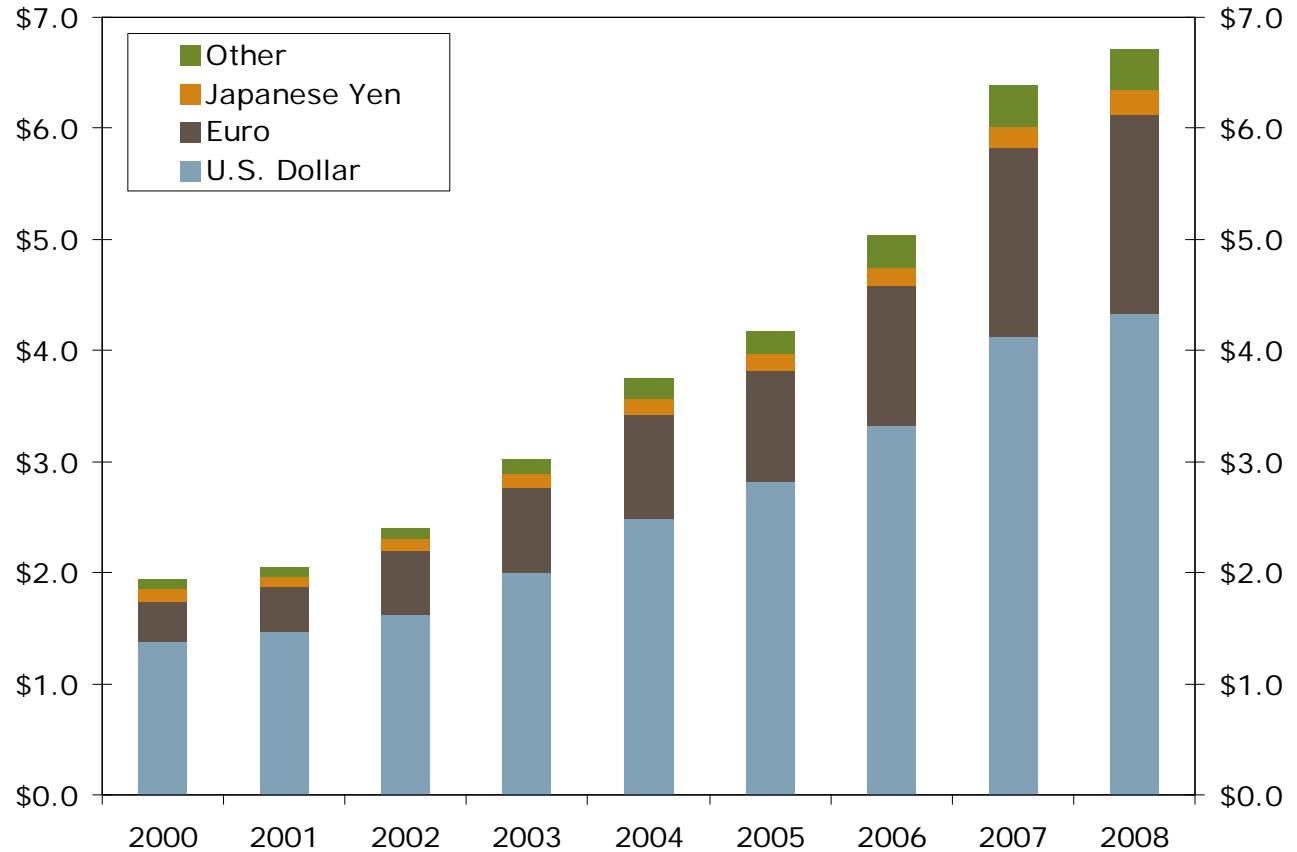
In Billions of USD



Source: U.S. Department of Commerce and Wells Fargo Securities, LLC

## Composition of Foreign Reserve Holdings

Trillions of U.S. Dollars

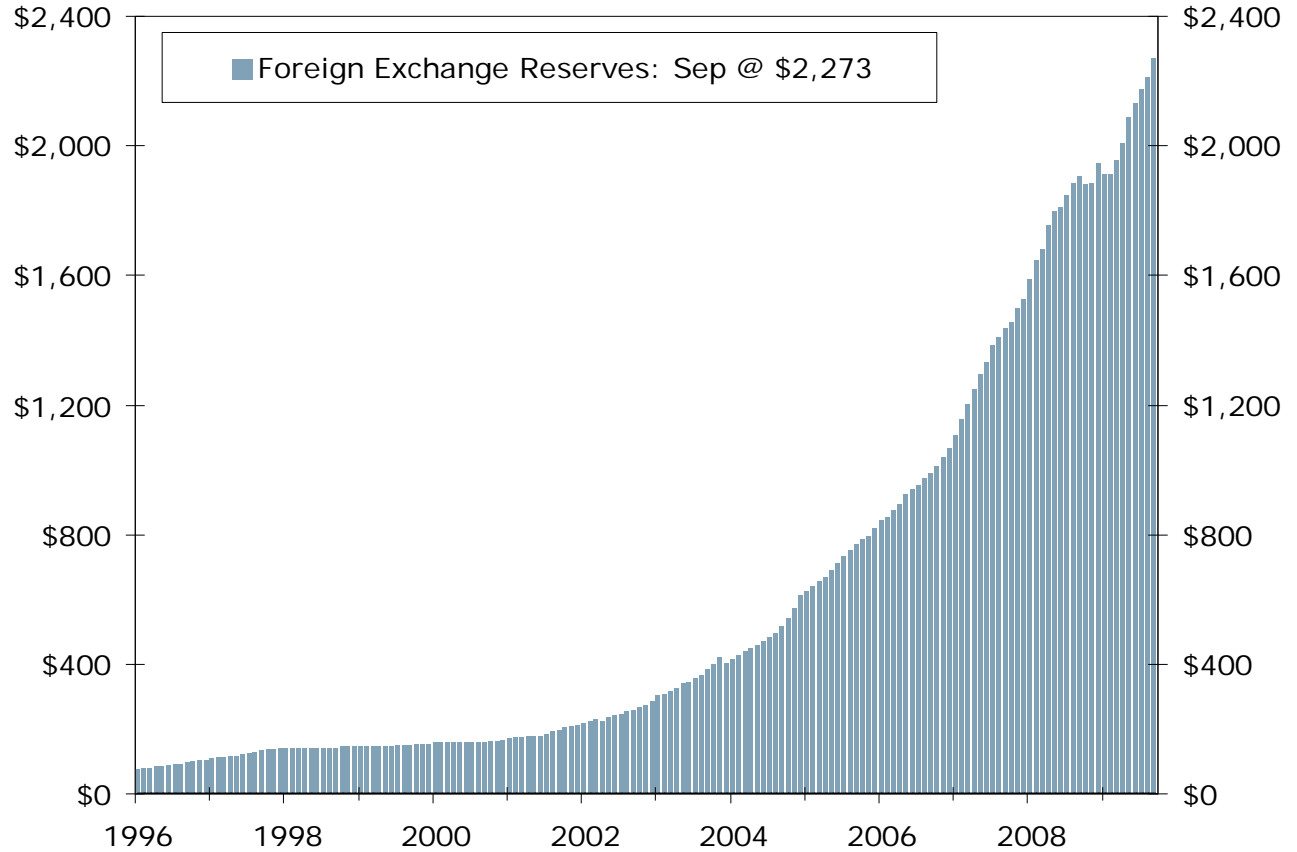


Source: International Monetary Fund and Wells Fargo Securities, LLC

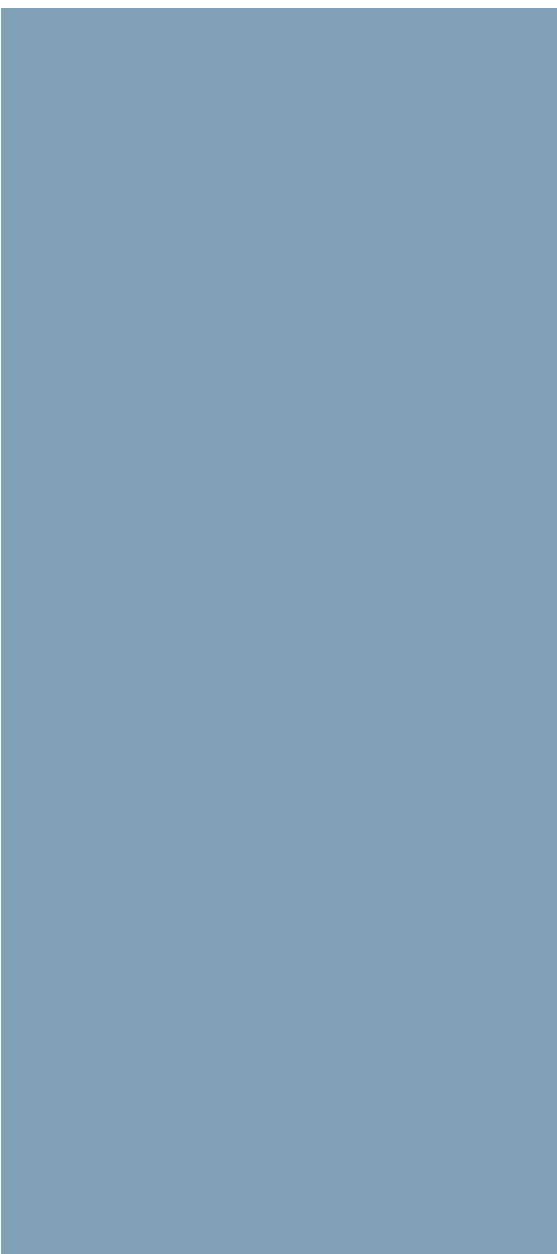
Straw boats borrow  
arrows  
(Zhuge Liang)

## Chinese Foreign Exchange Reserves

Billions of USD



Source: Bloomberg LP and Wells Fargo Securities, LLC



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**“Of all the stratagems, to know when to quit is the best.”  
-Chinese proverb**

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# Appendix

## A Sampling of Our Recent Special, Regional & Industry Commentary

Distribution Lists	Recent Special Commentary			
	Date	Title	Authors	
<ul style="list-style-type: none"> <li>▪ Monthly Economic Outlook</li> </ul>	December-31	Georgia Economic Outlook: December 2009	Vitner & Kamaruddin	
	December-31	Florida Economic Outlook: December 2009	Vitner & Kamaruddin	
	<ul style="list-style-type: none"> <li>▪ Weekly Economic &amp; Financial Commentary</li> </ul>	December-31	California Economic Outlook: December 2009	Anderson
		December-30	New Jersey Economic Outlook: December 2009	Vitner, Khan & Kamar.
	<ul style="list-style-type: none"> <li>▪ Special Reports</li> </ul>	December-15	Pennsylvania Economic Outlook: Spotlight on Jobs	Bryson & Quinlan
		November-18	Santa Tightens His Belt Another Notch	Vitner & York
		November-13	North Carolina Faces Difficult Road to Recovery	Silvia, York & Whelan
		November-11	Commercial Real Estate Chartbook: Q3	Vitner, Khan & Kamar.
		November-04	Did the Nation Overdose on Debt?	Silvia & Whelan
		November-04	An Economy at Non-Market Prices	Silvia
November-04		Inflation Chartbook: November 2009	Vitner, Khan & Kamar.	
November-03		How Bleak Is the British Consumer Spending Outlook	Bryson	
<ul style="list-style-type: none"> <li>▪ Economic Indicators</li> </ul>		October-20	What Is Gold Telling Us?	Bryson, Khan & Kama.
		October-19	Housing Chartbook: October 2009	Vitner & York
	<ul style="list-style-type: none"> <li>▪ Global Economic Commentary</li> </ul>	October-15	Beyond America, Canadian Economic Prospects	Bryson & Quinlan
		October-06	Georgia Economic Outlook: October 2009	Vitner & Kamaruddin
	<ul style="list-style-type: none"> <li>▪ Federal Reserve Commentary</li> </ul>	October-05	Comments Before Federal Reserve Advisory Panel	Silvia
September-24		What's Wrong With the Dollar?	Bryson	
September-03		Commercial Real Estate Chartbook: Q2	Vitner, Khan & Kamar.	
September-02		Clunkernomics: Auto Sales Set to Boost Real GDP	Vitner & Khan	
<ul style="list-style-type: none"> <li>▪ Real Estate &amp; Housing</li> </ul>		August-31	Benchmarking Recovery: Rhyming not Repeating	Silvia
	August-26	Will Debt Restrain Euro-zone Consumer Spending?	Bryson	
	August-24	State & Local Financial Woes Still Building	Vitner & Khan	
	August-18	Wobbly Fundamentals for Business Spending	Silvia & Quinlan	
	<ul style="list-style-type: none"> <li>▪ Consumer &amp; Retail</li> </ul>	August-14	Housing Chartbook: August 2009	Vitner & York
August-14		Healthcare Employment Stays out of the Sick Ward	Silvia, York & Whelan	
<ul style="list-style-type: none"> <li>▪ Chief Economist List</li> </ul>				

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