The impact of the Appreciation of the Chinese Yuan on the US Manufacturing Sector

John G. Kooti*
John L. Grove College of Business
Shippensburg University of Pennsylvania

Abstract:
Since 1985, the United States has incurred its largest bilateral trade deficit with China. Many associate this current account deficit and loss of American jobs in industries competing with rapidly rising imports from China. China’s reserve of the US dollar is now in excess of $2.45 trillion. This paper examines the impact of the appreciation of the Chinese Yuan on the US manufacturing sector.

*Corresponding Author: John G. Kooti, Shippensburg University of Pennsylvania, Professor and Dean, John L. Grove College of Business, 1871 Old Main Drive, Shippensburg, Pennsylvania 17257; Tel: 717-477-1435; Fax: 717-477-4003; Email: jgkooti@ship.edu
The impact of the Appreciation of the Chinese Yuan on the US Manufacturing Sector

The problem

The rise of China’s economic power and the accumulation of wealth resulted from significant growth in exports continues, other countries including the United States worry about the economic and financial consequences. The United States has lost many manufacturing jobs even in the capital intensive industries, as imports from the People Republic of China (PRC) have surged in recent years. Since 1985, the United States has incurred its largest bilateral trade deficit with China. US trade deficit with China increased from a balance trade in 1986 to $227 billion in 2009. Today, China is the largest exporter to the United States. In 2009 the US imported approximately $297 billion, exceeding the import from the EU of $281 billion. Many associate this deficit with the loss of American jobs in industries competing with rapidly rising imports from China, and other south east Asian countries. China’s exports to the US have been unprecedented, increasing from $4 billion in 1985 to approximately $297 billion in 2009. At the mean time, the US exports to China also increased, but at a significantly lower rate from approximately $4 billion in 1985 to approximately $70 billion in 2009. As we observe, the trade situation with China has deteriorated from a relative balance trade in 1985 to a huge imbalance in favor of China in 2009.

Although bilateral trade is good for both countries and allows for more efficient utilization of resources in addition to access to a very large Chinese market, many US industries are unable to compete and/or access the Chinese market.

The imbalance of trade is partly attributed by the Chinese authorities’ successful manipulation of the RMB to maintain global competitiveness. The Chinese Yuan was devaluated in the early 1980s as part of their policies to increase exports to the US. Following a significant pressure from the United States, in July 2005, China revalued its currency by 2.1% against the US dollar and moved to an exchange rate system that references a basket of currencies. Cumulative appreciation of the renminbi against the
US dollar since the end of the dollar peg was more than 20% by late 2008, but the exchange rate has remained virtually pegged since the onset of the global financial crisis. Since, the RMB is pegged to the US dollar, the devaluation of the dollar benefits the Chinese exports, since the dollar is a major international currency.

Recent reports indicate more willingness by the Chinese authorities to appreciate the Yuan against the dollar. However, many do not believe that the Chinese authorities will deviate too much from past practices, because China continues to focus on exports. China's focus on exports is attributed to excessively weak domestic consumption. Adil Mohommad, Papa N'Duye and Olaf Unteroberdoerster (2010) contributed the huge Chinese current account surpluses to a weak domestic consumption. Guo and N'Diaye (2010) concluded that weak consumption in China is largely due to low and declining share of household disposable income and a rising saving rate.

China's exposure to external demand from outside Asia has increased from 15% during 1995-2000 to over 19% during the 2001-2005 period. This trend mainly reflects China's growth of exports to advanced economies as it has become a hub of the region's supply chain network for advanced economies. While China's exposure to external demand continues, international businesses find it very difficult to compete effectively with domestic entities in China. The Chinese government vowed to continue reforming the economy and emphasized the need to increase domestic consumption in order to make China less dependent on foreign exports for GDP growth in the future.

**Objectives**

Global corporations such as Coca Cola have made more money in East Asia and Western Europe than in the United States in recent years. Currency fluctuations have more pronounced effect on the US businesses button line and the US economy in general than any other time in the US history. Profits earned in foreign currencies are worth more when the US dollar declines in value. SMS Elotherm, a small German manufacturer of machine tools signed a deal with DaimlerChrysler with $1.5 million worth of machines. The machines would be manufactured in Germany and exported to the United States. When the
deal was signed, the profit per machine was calculated at €30,000 each. Within three days that profit had declined to €8000 as a result of the steep decline in the dollar against the euro, since EMS would be paid in dollars, while its cost is in euro. Another small German company was more successful. Keiper is a small German supplier to US automobile companies fared relatively well during the same period because they built a plant in Ontario Canada, and the dollar remained stable relative to the Canadian dollar.

During the past 20 years, a new and different form of international business has developed that has greatly increased worldwide economic and political interdependence. Global corporations are now making direct investment in fully integrated operations worldwide. Brigham and Houston (2009) listed seven reasons for global corporations to operate worldwide - to seek production efficiency; to avoid political, trade, and regulatory hurdles; to broaden their markets; to seek new raw materials and new technology; to protect processes and products; to diversify; and to retain customers. United States Direct Investment in foreign countries increased from $222 billion in 1976 to approximately $3.7 trillion in 2008, and the total US assets abroad increased from less than half trillion dollars in 1976 to approximately $19 trillion. Foreign Direct Investment in the United States increased from $47.5 billion in 1976 to more than $2.6 trillion in 2008. Since, our main goal is to increase manufacturing jobs in the US, we can do this by either increase exports or by attracting foreign investment in manufacturing or a combination of the two. Although, significant attention has been paid to the impact of exchange rate fluctuation at the macroeconomic level, more attention needs to be paid to its impact on the US manufacturing sector and creation of jobs at home.

**Literature Review**

Since the collapse of the Bretton Woods system in the 1970s until now, the US dollar has inherited the role of reserve currency in the international monetary regime. The system based on the Jamaica Accord is also referred to as the Dollar Standard. Since the beginning of the 21st century, the most serious problem of the dollar standard has been global imbalance. It is evident in the consistent current account deficit of the USA as well as in the continued current account surplus of East Asian countries and resource-exporting economies. A consistent current account deficit will lead to rising net external debt owed by the US and once the net external debt exceeds a limit, the currency of that country will face significant depreciation pressure. Hence, an
international monetary system based on the US dollar will become unsustainable. Faced with the challenge of persistent trade deficit and depreciation of the dollar, the Obama Administration adopted export growth as a critical part of its economic recovery plan. Export growth in manufacturing sector should be the number one priority for the Administration. America is the world’s largest manufacturer, and exports are an important part of our manufacturing strength. The administration strategy to increase exports may not be easy given the rising role of China in the world manufacturing. Huw McKay and Ligang Song (2010) explained that China’s emergence as a manufacturing powerhouse has altered the distribution of power in the world economy in an irreversible fashion. The first half of the twenty-first century will be shaped substantially by the nature of China’s continuing engagement with a strategy of manufacturing-led development. Monga (2010) stressed the need for China to reduce its current account surplus and for the USA to reduce its current account deficit. In this literature, the attention of many developed world observers tends to be fixated on the role of exchange rate adjustment, particularly the appreciation of the Chinese yuan. Although it is now widely agreed that China needs to rebalance its economy, to reduce its reliance on export demand and to stimulate domestic demand, especially personal consumption, the United States Manufacturing sector cannot rely on the appreciation of the Yuan to increase exports. In addition, the appreciation of the Chinese Yuan against the US dollar may not be in the long-term interest of the US, as China moves away from using the dollar in international transactions. According to Ming Zhang (2009) the Chinese Government has stepped up its drive to reconstruct its international financial strategy after the sub-prime crisis developed into a global financial crisis in 2008. The main aim of the strategy is to reduce the country’s dependence on the US dollar in foreign trade, cross-border capital flows and foreign exchange reserve management. In order to achieve the goal of moving away from the dollar, according to Ming Zhang (2009) the Chinese Government has taken a series of actions on the international financial stage, which can be divided into three tiers, moving from the near term to long term: renminbi (RMB) internationalization, regional monetary cooperation and reconstruction of the international monetary regime. The three-tier steps reflect the Chinese Government's ambition to reshape its international financial strategy, the aim of which is to
comprehensively enhance the role of the RMB and some other currencies on the international market, and to reduce the dependence of China and East Asia in particular on the US dollar.

**Methodology**
NOT THERE YET.

**Data Collection**
NOT THERE YET.

**Results and Conclusions**
America is the world’s largest manufacturer, and exports are an important part of our manufacturing strength. Exports currently support millions of jobs across the country as currently one in every five American factory jobs depends on exports. Unfortunately, America continue to have a persistent trade deficit with China. US manufacturing trade deficit with China increased from $83 billion in 2001 to $277 billion in 2008 before declining to $240 in 2009 due to the great recession. Given China’s role as the world’s leading exporter and its huge trade surpluses – which the International Monetary Fund (IMF) has said are a major contributor to global trade imbalances – China’s highly undervalued currency (known as both the yuan and the renminbi) plays a key role in restoring global balance. The U.S. Treasury, the IMF, the European Central Bank and many others have pointed to the need for China’s currency to be more flexible and be allowed to appreciate in the direction of what a market-determined currency would be. We hope to come up with recommendations for successful strategies for improving US manufacturing competitiveness in the world, specifically with China.