

Real exchange rate and manufacturing employment in China

Ping HUA¹

CERDI-CNRS, Université d'Auvergne, 65, boulevard François Mitterrand, 63000 Clermont-Ferrand, France

Abstract

The impacts of the real exchange rate on employment and its channels are investigated. A real appreciation, (1) by switching factors from workers to imported inputs (technological channel), (2) by decreasing exports (export volume channel), (3) by exerting pressure on efficiency improvement (efficiency channel), exerts an effect on employment. Using the panel data of the 29 Chinese provinces for the period 1993–2002, the econometric results show statistically significant negative effects of the real appreciation of the renminbi on manufacturing employment. The three channels are statistically significant, the technological channel being the most important.

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1. Introduction

We know that China's exchange rate policy matters. Currently, China is under considerable pressure from industrialized countries in favor of re-evaluation and a more flexible exchange rate regime of the renminbi.² The stable parity around 8.27 yuan/US\$ since 1998 is considered as a price advantage for Chinese products on the markets of developed countries; and is held to be responsible for the increasing unemployment in their manufacturing sectors (Goldstein, 2004; Holtz-Eakin, 2003). The appreciation of the renminbi against the US dollar (2.1%) and the change in China's exchange rate regime on July 21, 2005 have received a warm welcome in these countries and provoked a new debate on its economic consequences in China (McKinnon, 2005).

E-mail address: P.Hua@u-clermont1.fr.

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² The name of the Chinese currency is the renminbi and its unit is the yuan.

However, one effect which was perhaps not expected is that, since the 1990s, China has lost more manufacturing jobs than the United States and other major countries. From 1995 to 2002, China lost 15 million manufacturing jobs, compared with 2 million in the U.S. (Xu, Spiegelman, McGuckin, Liu, & Jiang, 2004). Moreover, it lost manufacturing jobs in those industries where the U.S. and other major countries have also seen jobs disappear, such as textiles. The U.S. lost 202,000 textile jobs between 1995 and 2002, but China lost far more jobs in this sector (1.8 million). All told, 26 of China's 38 major industries registered job losses between 1995 and 2002.

Where it differs from developed countries is that China has gained jobs in service industries which created 42 million during the same period. The share of employment in the tertiary sector relative to total employment increased from 25% in 1995 to 29% in 2002, while that of manufacturing employment decreased from 14% to 11%. However, these job creations in services are not sufficient to resolve the unemployment problem which has become so serious that the development of labor-intensive manufacturing industries has regained prominence on the Chinese government's agenda, whereas they were previously discouraged in favor of capital- and technology-intensive industries (China Daily, 2003). While the number of registered unemployed persons in urban areas increased from 3.5 million in 1991 to 8 million in 2003 (with an unemployment rate of 3.6% and 4.3% respectively), the real unemployment situation is more serious. Using data from a unique survey conducted in five large Chinese cities, Giles et al. (2005) find that unemployment rate was 14% for urban permanent residents in 2002. They estimated, for China as whole, that the urban permanent unemployment rate increased from 6.1% to 11.1% from January 1996 to September 2002.

This loss of Chinese manufacturing jobs coincided with a period of real appreciation of the renminbi which increased at an average rate of 4.1% per year from 1993 to 2002.³ The manufacturing exports increased at a lower annual average rate (13%) during this period of real appreciation than during the previous period from 1981 to 1993 (19%) when the real exchange rate of the renminbi depreciated at an annual average rate of 7.8%. These decreasing manufacturing exports resulting partially⁴ from the real appreciation exert a negative effect on manufacturing employment, which decreased at an annual average rate of -2.3%, from 93 million in 1993 to 83 million in 2002, i.e. a loss of 10 million manufacturing jobs. Inversely, during the previous period, the increased manufacturing activities partially stimulated by the real depreciation of the renminbi allowed firms to employ more workers. The Chinese manufacturing employment increased at an average of 3.9% per year on average, from 53 million in 1978 to 93 million in 1993, i.e. a creation of 40 million manufacturing jobs (Fig. 1).

This negative relationship between real appreciation and manufacturing employment is also evident at provincial levels. All the Chinese provinces experienced a real appreciation⁵ during the

³ The real effective exchange rate is calculated as the nominal effective exchange rate multiplied by the ratio of consumer prices between China and its foreign partners. During the period of double exchange rates, a weighted official and swap exchange rate is calculated instead of the official rate (Guillaumont Jeanneney & Hua, 2001). An increase means an appreciation. For details of China's exchange rate policy, see Section 3.2.1. The data used for the calculation are reported in the Appendix.

⁴ Real exchange rate appreciation is one of the factors explaining the slowdown of China's export growth.

⁵ The real effective exchange rate differs from one province to another because the provinces have different swap rates in 1993 (Khor, 1993), as well as different rates of inflation and different foreign trading partners (Guillaumont Jeanneney & Hua, 2002).

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