On Concern over Inflation

By Noboru HATAKEYAMA

Back in the 1990s, the US economy prospered without inflation. Its average growth rate was 2.9% in the 90s as compared to 2.6% in the 70s and 0.9% in the 80s. In spite of the rather high 90s growth rate, the average rate of increase in the US CPI was only 3.0 % during the 90s although the corresponding rate in the 70s and 80s was 7.0% and 5.5%, respectively. This was realized at least partly because of imports of inexpensive Chinese goods. The weight of US imports from China in the entire GDP of the United States increased to 2.1% in 2005 from 0.1% in 1995, more than 20 times the level of 10 years ago. [The US outsourcing of services to India must also have contributed to restrain the inflation rate in the 90s. The amount of outsourced services is not available, although we can guess to some extent from the amount of India's exports of services to the entire world being $86 billion in 2007, equivalent to 25% of China's exports of goods to the United States.]

Roughly speaking, the Household Registration Act in China had been implemented severely until the 90s. Due to this law, people living in rural areas were not allowed to leave their native places for cities unless they had jobs and dwellings there. Taking advantage of this system, executives of companies, including foreign affiliates, located in cities hired abundant workers from rural areas and asked them to return to their hometowns for the last time after a given period, say three years after their employment. During the three years, it is said that wages of those workers hardly went up and new workers replaced them with almost the same wages and other conditions as those of the former employees.

This was the secret that had kept products made in China so inexpensive for such a long period of time. In the case of other countries, the population of farmers declined in accordance with their economic growth. Such a shift did not happen in China where a secure supply of workers from rural areas was maintained because of the Household Registration Act.

Now, as we have entered the 21st century, the enforcement of this law in China has started to ease, thereby weakening the ability of executives to lay off workers three years after their employment, for example. Then, wages for workers remaining at the same companies started rising, partly reflecting a seniority system, especially for those employees continuing to work for more than three years. The looser enforcement of the Household Registration Act may have been attributed to the fact that the awareness of freedom to choose where to live has increased on the part of Chinese people and also to the relative shortage of workers in some rural areas near coastal regions.

Thus, the United States may not be able to enjoy those inexpensive goods coming from China any longer. Therefore, if the US were to experience another round of economic prosperity now, it would have to be prepared for concern over cost-push inflation coming especially from China.

The United States was not alone in enjoying China's inexpensive goods. Being a neighbor to China, Japan made full use of inexpensive Chinese goods. Some small companies in Japan even invited Chinese workers to their factories in a cost-reducing attempt.

In addition to cost-push inflation mentioned above, there has emerged concern over demand-pull inflation as well. With their economies growing more than 10% per annum in recent years, China and India have started importing iron ore and coal that they used to export. Partly because of this, international competition for purchasing iron ore and coal has become fierce recently, sending their prices skyrocketing twice or three times within one year. The same is true with other raw materials, including oil. This is a typical type of demand-pull price hikes.

In the case of the United States, in addition to these concerns over cost-push and demand-pull inflation, there is another anxiety over inflation. That is a possibility of the dollar's value falling and subsequentlly raising prices of imported goods and services. With a big trade deficit of more than $800 billion in each of the last two years, the dollar's decline as compared to the trade value-weighted average of other currencies should be a probability rather than a possibility, at least in the long run.

On the other hand, whether the Japanese yen will go up or down in value remains to be seen. It will be probable for the yen to go up against the dollar. When it comes to comparison between the yen and the euro, it will depend on how Japan's and euro-bloc countries' economies will succeed in carrying out necessary reforms, including tax reform on the part of Japan. JS

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