Lure of 'China Price' Gets More Expensive

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Article:

In recent years the phrase "China Price" has scared American manufacturers, who are often pressured to match the low prices of Chinese imports. But now the China Price is rising. While the trend of outsourcing to China is unlikely to be reversed, it may well be slowed. Here's why:

Rising Fuel Prices

The advent of containerized shipping lowered costs and made the modern global supply chain possible. Outsourcing to low-wage countries became a viable alternative. The result was a revolution in the way products are made and sourced. But the revolution got a big assist from fuel prices that fell steadily in real (i.e. inflation-adjusted) terms.

Things are different now. Oil prices have been trending upward since 2002 (up 90 percent in the last year alone!), thanks to stagnant supply and rising demand from emerging economies, especially in Brazil, Russia, India and China. Every dollar increase in the price of oil adds a de facto tariff that makes imports less attractive.

Not surprisingly, this has changed the equation of shipping containers from China. A new study by CIBC World Markets finds that the average cost of shipping a standard 40-foot container from China has nearly tripled since 2000.

Just as drivers are starting to adjust to higher gasoline prices, shippers are starting to alter supply chains. The Wall Street Journal recently reported anecdotal evidence that some manufacturing jobs are returning to North America due to higher fuel prices. The CIBC study finds that Chinese imports of products (like furniture) with low value-to-weight ratios (for which shipping costs make up a large proportion of total costs) are already declining.

Rising Wages

China's rock-solid advantage since the start of its push for export-led economic growth has been its low wage rates, fueled by an apparently endless supply of rural laborers. But even China is finding that human capital is not inexhaustible, in part because of the country's restrictive "one child" policy and in part because economic growth is creating other opportunities for talented workers. Chinese manufacturing wages have risen by double-digit percentages since 2002, much faster than in the 1990s and even faster than the economy as a whole has been growing.

Chinese wages must be much lower than U.S. wages for outsourcing to work, due to elevated costs of quality control, managerial oversight and of course transportation. Consequently, while wages are still low in China, there is growing pressure on manufacturers to find even lower wages, whether in China's interior or in other countries.

Other Developments

For years, China kept its currency cheap relative to the dollar in order to encourage exports to the U.S. In 2005, China changed its currency policy, and since then it has risen about 16 percent against the dollar. At the same

time, the dollar has undergone an extensive devaluation against major currencies, including a nearly 40 percent drop against the euro since 2000.

The dollar's overall decline has hurt Chinese revenues, and it's connected to a number of rising material prices that Chinese manufacturers must pay (especially oil, which is traded in dollars).

Rising prices for other commodities, notably food and metals, are also pushing up the prices that Americans pay for products made in China. Overall, we're experiencing a kind of "perfect storm" of inflationary effects.

Will high fuel prices, rising wages in China, the weak dollar and rising commodity prices cause American manufacturing to rebound suddenly? It's unlikely. In many industries, the beneficiaries will be Mexico and Central America; in others, Vietnam and Malaysia. But with relatively low rates of manufacturing capacity utilization in the United States, there's room here to absorb some increased production.