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The 'Great Disinflation': The Importance of the 'China Factor' Is Overstated. A Note

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Abstract
Contrary to common beliefs China's integration into the global manufacturing system does not seem to have depressed the wage shares in the advanced countries. If anything, it also failed to raise unemployment rates in the advanced countries. The 'Great Disinflation' theory advanced by Goodhart and Pradhan is unconvincing and so is their conclusion that the approaching great demographic reversal augurs an inflation revival.[1]

Keywords: globalisation, wage shares, inflation, demographic reversal

JEL Codes: E24, E31, F15, F62

The recent work by Goodhart and Pradhan (2020) suggested that the long era of low inflation might be coming to an end: '… globalisation and demographic shocks have led to an extraordinarily deflationary trend over the last 30 years …' (p. 9). 'The integration of China into the global manufacturing complex by itself more than doubled the available labour supply for the production of tradeable products among the advanced economies' (p. 2). '… The economic effects of this have been a dramatic … weakening in the bargaining power of the labour force … no wonder that the deflationary forces have been so strong …' (p. 5). But '… The Great Reversal Is Now Starting …' (p. 9): '… a sharp decline in the number of those entering the labour force …' plus increased demand for labour needed for looking after the elderly, whose numbers will increase very strongly and rapidly (p. 11).

This Note argues that the effects of China's integration into the world economy may not have had much of a disinflationary effect on the advanced economies until relatively late. Moreover, it suggests that the repression of wages in the advanced economies took place *before* the full-scale integration of China into the global trading system. Demography need not have been responsible for the repression of global inflation. Therefore, the approaching demographic reversal does not necessarily augur a revival of high inflation.

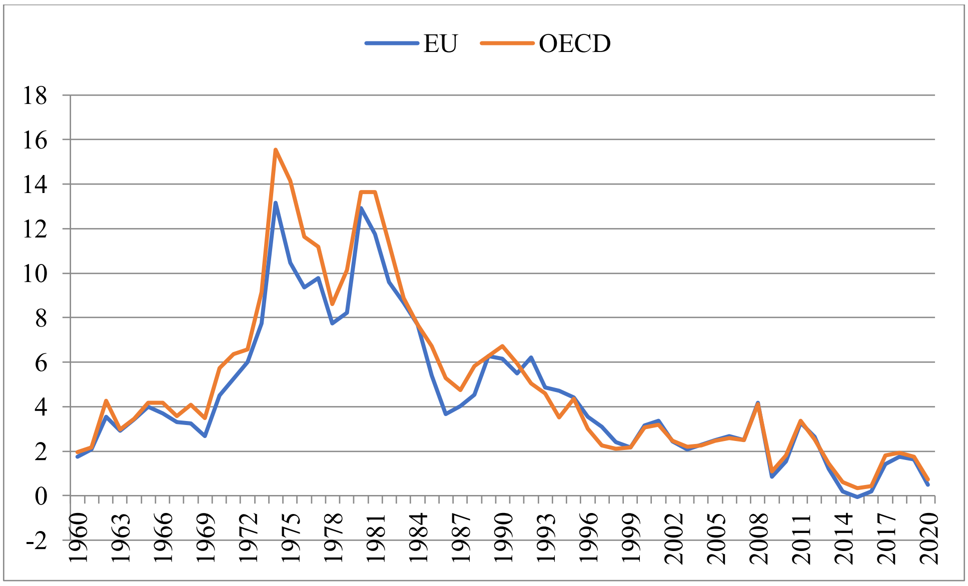
[1] The views expressed in this text are those of the author and do not necessarily represent the views of the author's employer.

A brief history of disinflation in advanced economies

The collapse of the Bretton Woods system in the early 1970s coincided with inflation rising in the advanced economies. The two exogenous oil-price shocks (1973 and 1979) hitting the global economy provoked high inflation which peaked in 1975 and 1980-81 (see Figure 1).

Moderate/low inflation (starting from around the mid-1990s) was preceded by several years of gradual disinflation which may be attributed to several factors. First of all, a plunge in oil prices (1986). Besides, economic growth during those years, additionally punctuated by recessionary episodes (1981-82, 1993), was anaemic. Later recessionary episodes (2002-03, 2008-09, 2012-13) occurred already during the low inflation years. Those episodes may have kept inflation under control as well. Low and unstable growth itself was, arguably, a consequence of economic policies enacted, especially in the 1980s and until the mid-1990s. During these years real interest rates were abnormally high: the monetary policies were instrumental in restricting both inflation and economic growth.

Figure 1: Inflation in the advanced economies since 1960



Source: WDI

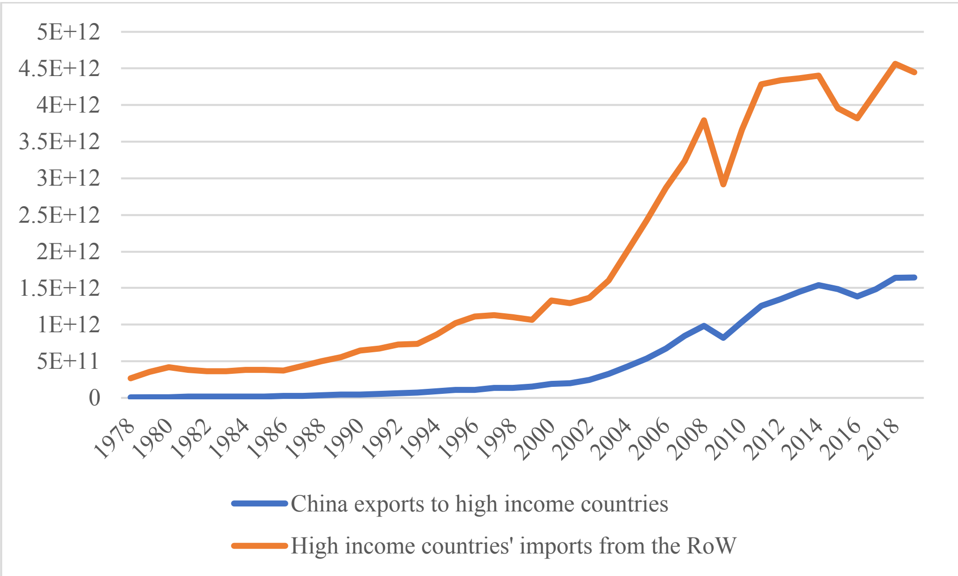
The 'China factor' may have operated since about 2005 but …

China entered the World Trade Organisation in 1997. But it took several years for China to become an important partner of the advanced countries.[2] Chinese merchandise exports to high income countries had long been insignificant as compared with the high-income countries'

[2] The same applies to the former Central and East European 'planned economies'. In the early 1990s these countries experienced 'shock therapies' (administered by the fans of the 'Washington Consensus'). The 'therapies' were followed by long and dramatically deep recessions. These countries' industrial capacities were (unconstructively) destroyed in the process. Later (around or after 2000) Central Europe (but not Ukraine or Russia) was gradually integrated into the global (actually West European) economy.

merchandise imports from the rest of the world (i.e. from the low and medium income countries)[3]. Only by 2003 Chinese exports to the high income countries started to rise (Figure 2).

Figure 2. Chinese merchandise exports to the high income countries and merchandise imports from the rest of the world by the high income countries (in USD)



Source: WDI

The integration of China into the global economy effectively started around that year, not quite '30 years ago'[4]. Until that year Chinese exports to high income countries were minute compared with total imports of the high income countries, or even relative to their imports from other low-to-medium-income countries. Thus, it is perfectly reasonable to expect the post-2003 developments to have had some impact on the economic fates of the latter. But there is little justification for the claim that China's exports could have played a significant role in the initial years of intensified globalisation (since around 1990 until the early 2000s).

… it did not affect wage shares in the high-income countries

The presumed deflationary consequences of China's integration into the global economy should have materialised through the repression of wages in the high-income countries (via a

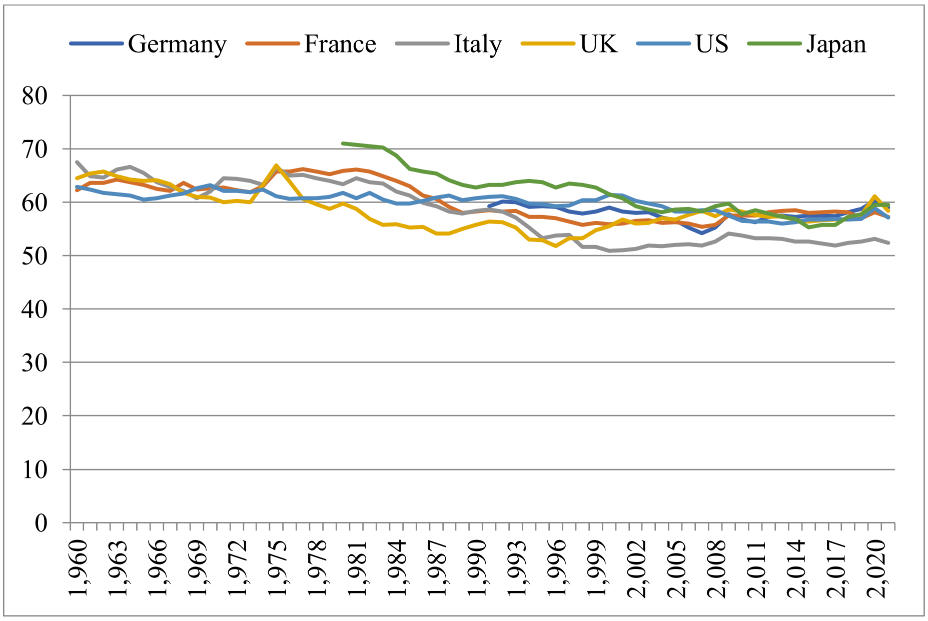
[3] The high income countries trade primarily with themselves. Collectively their 'inward' trade accounts for about 70 percent of their total merchandise exports and 65 percent of their total merchandise imports. Imports from China accounted for 3.5 proc. of the total merchandise imports of the high income countries in 1997. By 2004 that share had increased to 6.8 proc. Recently that share is about 13 proc. (down from the peak of 14.2 in 2015).

[4] Goodhart and Pradhan book 'was mainly written in 2019' (p. 213). The implied starting date for China's entrance into the global economy is 1989 – much too early by any account.

'dramatic weakening of the labour's bargaining power'). But this presumption is hard to square with the available data on the (adjusted) GDP labour share.

Figure 3 suggests that the GDP wage shares in the major advanced countries had followed declining trends until the early 1990s. Later on, these shares either stabilised or even rebounded slightly (see Table 1).

Figure 3: Adjusted GDP labour shares, major advanced countries



Source: AMECO.

Table 1: Changes in the adjusted GDP labour shares, major advanced economies .

	Germany	France	Italy	UK	US	Japan
1960-1975		3.5	-1	2.4	-1.8	
1975-1990		-7.5	-8.1	-11.1	-0.3	*-8.3a*
1990-2005	*-2.7b*	-2.1	-6.4	0.9	-2.5	-4.1
2005-2020	3.7	1.9	1.1	4.4	0.6	0.9

Source: AMECO. a: years 1980-1990. b: years 1991-2005

Evidently, the downward adjustments in the labour shares occurred *before* China's exports effectively entered the world market (and before the full-scale liberalisation of trade and capital flows that took place around 1990). In most cases the years 1975-1990 were really critical in that respect. But the years 2005-2020 witnessed some rebound in the labour shares. Data on the average unemployment rates convey much the same message: unemployment tended to contract *after* 2003 (see Table 2). Apparently, the fast rising Chinese exports did not push the employees in the advanced countries out of work – at least within a couple of years following 2003. (After 2008 the unemployment rose, evidently under the impact of the Great Recession and – in the Euro Area – also during the secondary recession in 2011-12. The later recovery pushed the unemployment rates further down.)

Table 2: Average unemployment rates

	1990-95	1996-99	2000-03	2004-07	2008-15	2016-19
Euro Area	9.6	10.4	8.4	8.5	10.3	8.8
UK	9.1	6.8	5.2	5.1	9.9	4.3
USA	6.4	4.8	5.1	5.0	7.1	4.2
Japan	2.5	3.9	5.1	4.3	4.4	2.7

Source: AMECO.

Concluding remarks

The ‘Great Disinflation’ since about 1990 appears to have coincided with progressing globalisation and a seemingly massive increase in the global availability of labour force. However, China’s expansion, effectively since about 2003, cannot be really invoked to explain the deflationary tendencies. Contrary to common beliefs China’s integration into the global manufacturing system does not seem to have depressed the wage shares in the advanced countries. If anything, it also failed to raise unemployment rates in the advanced countries. The ‘Great Disinflation’ theory advanced by Goodhart and Pradhan is unconvincing and so is their conclusion that the approaching great demographic reversal augurs an inflation revival. An alternative explanation of the inflation trends since the mid-1980s may point out to the fact that, contrary to ‘common knowledge’, the deepening and widening globalisation has depressed global economic growth (Podkaminer, 2015, 2021, 2022). That, in turn, may have been instrumental in restricting global inflation.

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