U.S. Car Manufacturers Survival in New Trading Grounds

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Abstract: The text explores reasons why Ford and GM voluntarily increased their operations in China, and how policies of the Trump administration are affecting the U.S. automobile industry with its attempts to force Ford and GM to bring some of those investments back to the U.S. Policies enacted under President Trump have been successful in forcing Ford and GM to invest more in the U.S.; however, because of other hurtful government decisions and these companies' (Ford and GM) previous actions of increasing their presence in China, Trump's approach will lead to an increase in the companies' costs and potentially make them vulnerable to future financial struggles.

I. Introduction

President Trump's administration has begun to enact policies which will greatly impact economic and business decisions for U.S. manufacturers. These policies will directly impact the way U.S. car manufacturers will conduct business in the coming years, forcing them to stop their current investment plans. Ford and GM are on a constant race to increase their profits by increasing their revenue and lowering their cost, and due to the constant increase in sales until the 2016 U.S. Presidential Election, (Carsalesbase, 2019)[1,2] increasing car production in China was the route to take for these companies to approach this goal. In a period when consumers have evolving tastes, one of the safest and effective ways of dealing with those uncontrollable forces is by lowering costs of production. Therefore, it makes sense for Ford and GM to increase their activity in China due to the potential of lowering cost because of China's low minimum wage, low corporate income taxes, and favorable exchange rate.

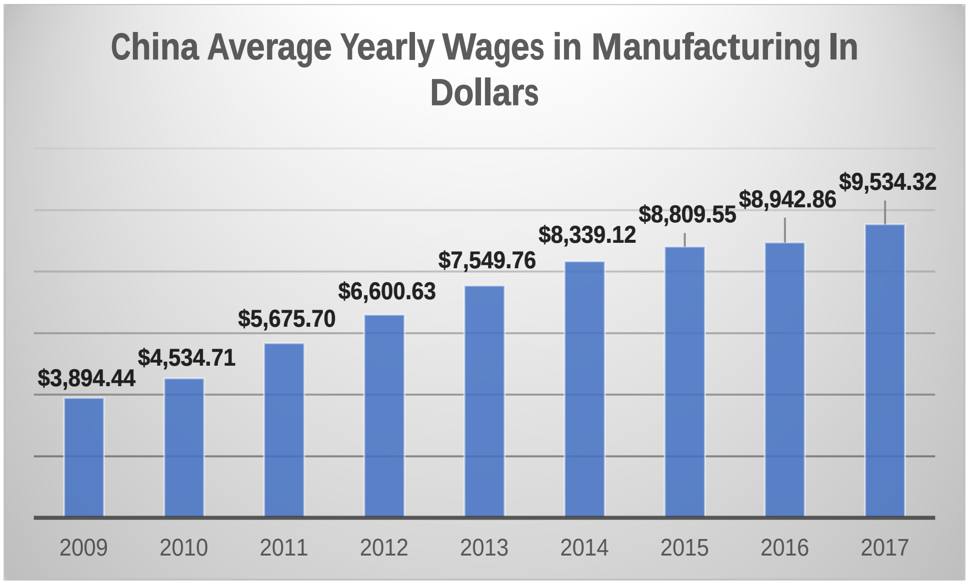
This paper will explore and minutely review the main reasons why U.S. car manufacturers moved part of their operation overseas, with an emphasis on the impact of the Trump administration's actions on the way U.S. car manufacturers do business in 2019 and suggestions to increase manufacturing jobs in the U.S.

II. Minimum Wage and Wage differences Between China and the U.S.

The minimum wage is a highly debated and controversial topic among policymakers. A minimum wage is a price floor that not only prohibits employers from paying people less than a certain amount per hour for their work, but simultaneously prohibits people from supplying their labor for less than that minimum amount. Arthur Laffer (a recognized American economist who served on President Reagan's Economic Policy Advisory Board) in a newsletter published by

MSNBC

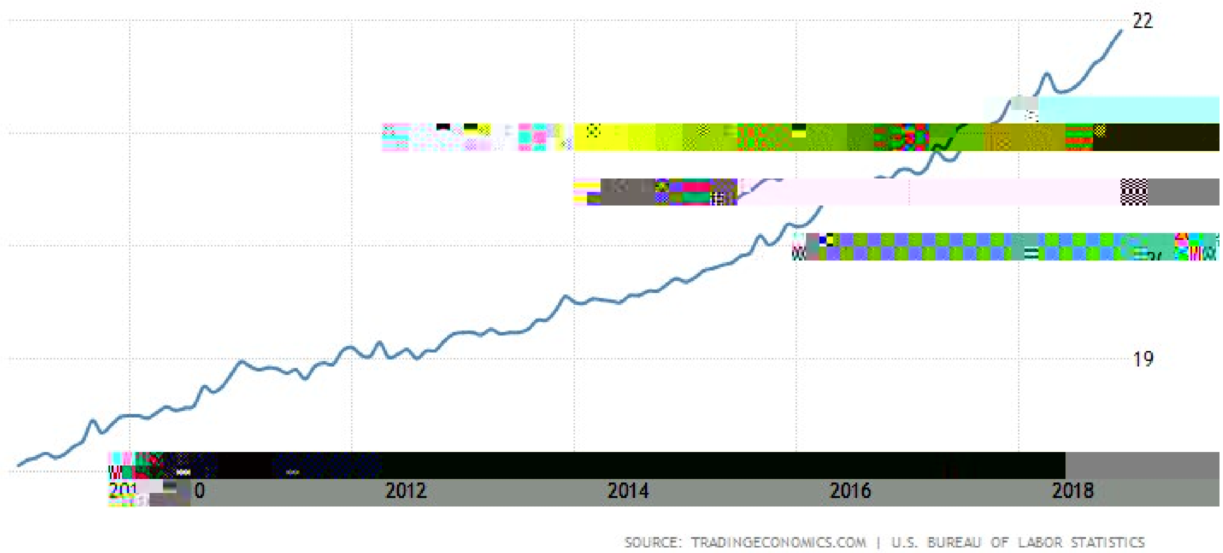
China's average yearly wages in manufacturing grew approximately 12% per year on average from 2009 to 2017. This is even with diminishing growth rates in 2016 and 2017 (years which had the smallest percentage increase in average wages over this period).[4]



There is an incentive for automobile manufacturers to take advantage of China's inexpensive labor, and this incentive is magnified by average manufacturing wages in the U.S. Pacific Economic Review assures that there "remains an enormous gap between manufacturing wages in China and those in developed economies" (Tao Yang, 2019 p. 493).[5] U.S. manufacturing wages have shown an alarming upward trend that has kept its momentum for the past 9 years, as observed in the following graph shared by *Trading Economics* (Tradingeconomics.com, 2019).[6]

Chinese labor has experienced a phenomenon that uses one of the U.S. disadvantages as an advantage, which is one of the main reasons why Chinese labor is so inexpensive. In 1990, China established a minimum wage in order to increase wages for their lowest paid workers. For China's export market, the minimum wage does not really function as a price floor, but rather is essentially the set price for labor. The reason this phenomenon has trended over the years in

China is because of where the supply of labor comes from and the decentralization of the minimum wage (Chan, 2006).[7]



The supply of labor for China's export market comes mainly from the migration of countryside workers who are used to a lower standard of living than the urban population. The constant supply of these countryside workers is the main force pushing the wages for the export sector to stay close to the minimum wage.[7]

In combination with wages being pushed down to the minimum by China's supply of countryside workers, the government is the force keeping minimum wages low. Minimum wages in China are for the most part decentralized. Cities in China can set their own minimum wage, making it difficult for employers to perceive the minimum wage as a base price. This decentralized minimum wage also allows the government to formulate a minimum wage based on the standard of living, causing the minimum wage to move at a rate no faster than inflation.[7]

Apart from minimum wages, there are multiple factors driving U.S. wages to their current levels. Some of those factors are labor unions. U.S. labor unions were created to improve worker's conditions in the country not only by helping workers improve their wages but also obtaining more benefits, such as health insurance. The Bureau of Labor Statistics states that in 2018, approximately 1,461,000 manufacturing workers in America were members of unions. Union workers are estimated to earn 22.2% more than non-union workers, which contributes to the rise of labor costs in the country. [8] In contrast to U.S. labor unions, David Metcalf and Jianwei Li from the CenterPiece online magazine assure that unions in China "are not properly functioning unions." They state, "despite their huge membership, unions are likely to remain largely nugatory in Chinese labor relations." Because labor unions in China fail to work as intended, China's labor costs have not been affected by these unions, making the gap between labor costs in the U.S. and China greater than it otherwise would be.[9]

Labor costs in the U.S. are very unattractive for U.S. automotive manufacturers. As a direct comparison, the Bureau of Labor Statistics shows that U.S. car manufacturers pay Chinese employees about a tenth of what they pay American workers.[10] An abrupt change in policies that would bring mannufacturing labor to the U.S. will be ineffective and can prove to be harmful for U.S. automotive industries, which drive a high percentage of the country's GDP, between 3 to 3.5% (Hill, K., Cooper, A., & Menk, D.).[11] *Ceteris paribus*, when the demand of something increases the peter0.96 Tm( )Tj[(A)2 (n apa-2 (n)]TJ-0.0)2 (., C)hue w64 1-4 (e p)-4( )Tj[A he pbuss a di hibus

III. Exchange Rate

The strength of the dollar relative to the Chinese Yuan has been a main driver in moving production to China. Moving operations to China has enabled U.S. companies to gain an advantage from changing some of their cost to Yuan. For the past 10 years, the average closing price of the Yuan has ranged from 6.15 to 6.83 per dollar. One of the main reasons the Yuan attracts companies to increase production in China is that it is relatively stable. (Macrotrends.net, 2019).[12]

China's ability to maintain mild fluctuations in their currency despite their rapid increase in their current account surplus is admirable. Green (2008) states, "China's absolute current account surplus was the largest of any country in the world." [13] Despite the rapid growth in China's current account, China has maintained an even faster growth in their reserves, thus maintaining a low and stable currency.

In addition to the stability of China's currency, the relative exchange to dollar from China's Yuan has attracted Ford and GM to move some cost to Yuan. Having revenue in dollars and expenses in Yuan has been a target for these two car manufacturers for more than a decade and could mean major production cost savings, ensuring these companies' future survival.

IV. Corporate Income Taxes

Taxes originated with the ideas of raising money and discouraging non-wanted behavior. However, U.S. corporate tax rates appear more of a punishment for conducting business in the country than a way to raise money for government operations. Between 1993 and 2017, the United States has had a flat 35% corporate income tax, making it the country with the higher corporate income tax between China and the U.S. (Tradingeconomics.com, 2018). [14]

The automobile industry has historically been a source of the pride for the U.S. However, because of previoe or, Ue- (, U) (u(1 (e T)-7 (a) (w)-2p(he)]TJ [(t)-2 (he)cj[(of)3 (r)3 (a)4 (i.1410 (a)]TJ8.74 Tc release, GM sold "about 32,000" units at a base price at "$34,065" in the U.S. Shortly thereafter, Ford announced that by 2019, it would move all production of the Ford Focus to China. Ford sold "113,345" (Ford Authority, 2019)[16] units of the Ford Focus in 2018 alone, making it one of their top selling cars.

General Motors and Ford have taken steps to increase production in China, proving that manufacturing cars and importing them back to the U.S. is feasible and can be expected to be profitable. A company engaging in this strategy not only saves in production costs, but also newsletter published by MSNBC (2014), Laffer conjectures that a tax rate of around 20% is close to the peak, meaning the point where tax revenues will be maximized.

President Trump secured a deal with China where China agreed to lower tariffs for the U.S. from 25 percent on cars and from 20 percent on trucks to 15 percent. Unfortunately, this deal

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