Imports from low-wage countries: what gains for households?

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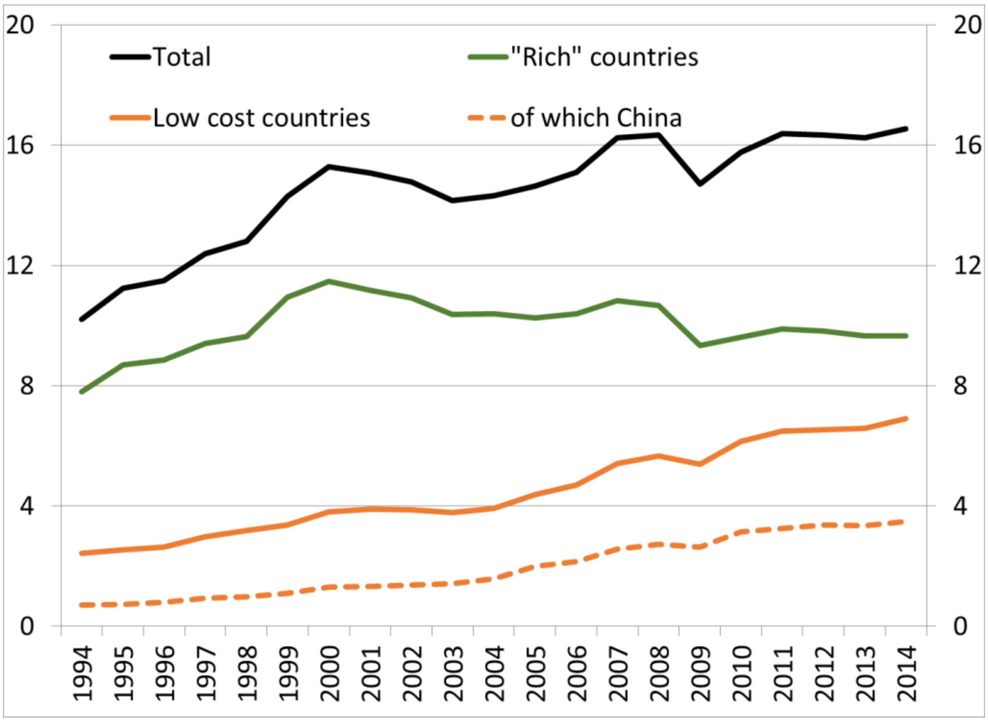
The share of imports from low-wage countries in French households' consumption increased threefold from 1994 to 2014. These less expensive imports lowered inflation in France by 0.17 pp per year on average. This direct effect of imports since 1994 represented a gain of about EUR 1,000 in terms of average household consumption in 2014. However, the indirect effects of opening up to international trade on households' purchasing power, via wages and employment, were not taken into account.

Chart 1: Share of imports in households' consumption (in %)



Source: Carluccio et al. (2018) based on Customs and INSEE data

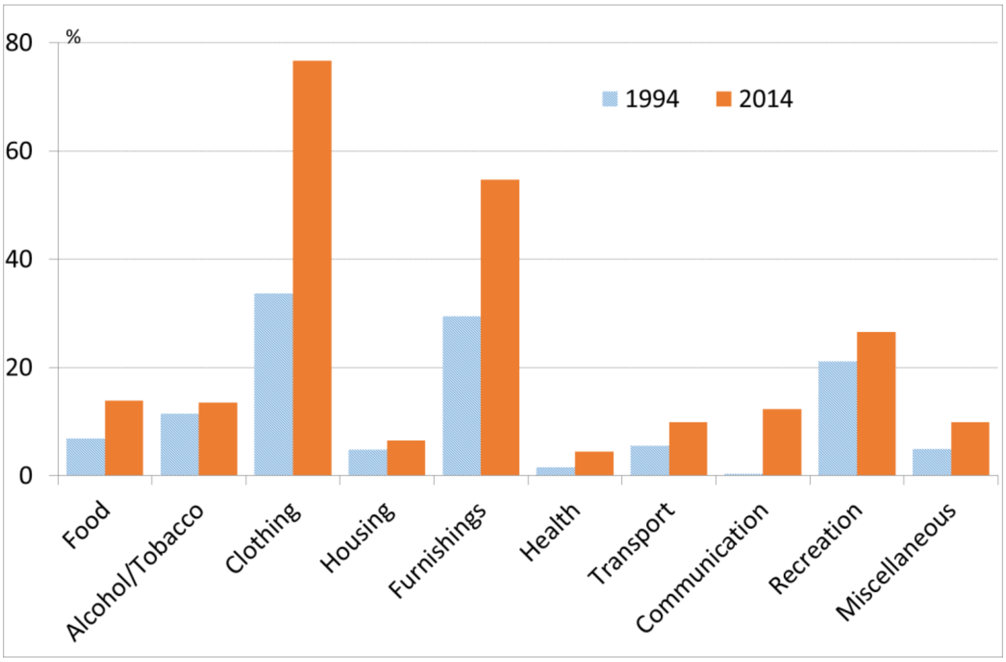
Note: Only imports of final goods that are included in household consumption are taken into account.

From 1994 to 2014, international trade openness raised the share of imports from low-wage countries (in particular China and Eastern European countries) in French households' consumption. One of the benefits of this openness is the possibility of having access to cheaper goods. We estimate the impact of imports from low-wage countries on CPI inflation in France between 1994 and 2014 at -0.17 pp per year (see Carluccio *et al.*, 2018). This effect takes place through three channels each representing about one third of the total. 1) Households replace consumer goods produced in France by goods imported from low-wage countries. If these are cheaper, this substitution reduces domestic inflation. 2) For the same level of imports, households consume relatively more products imported from low-wage countries. This leads to a decline in imported inflation and then in CPI inflation. 3) French companies react to the new competitive pressures by cutting their margins and prices. These channels describe short-term effects, averaged over the period. We do not include general equilibrium indirect effects, such as the price response of non-tradable goods, the monetary policy response, and a possible change in domestic demand.

A significant albeit circumscribed effect on inflation

Between 1994 and 2014, the share of imports in households' consumption rose from around 10% to 17%. Low-wage countries are the main contributors to this increase: the share of imports in consumption climbed from 2% to 7% over the period (Chart 1). Yet, the prices of these goods are 40% lower than those of equivalent goods manufactured in France (see Carluccio *et al.*, 2018). In total, substituting imported goods for goods produced in France had a negative effect on inflation of -0.05 pp per year over the period (assuming the prices of other goods remain unchanged and there is no monetary policy reaction).
Despite being substantial, the substitution effect is circumscribed to a few categories of goods: clothing and footwear and furnishings and household equipment account for -0.04 pp of the -0.05 pp effect on inflation. These goods saw a sharp rise in the share of imports in consumption (Chart 2) and imports from low-wage countries largely contributed to these increases.

Chart 2: Share of imports in households' consumption by product



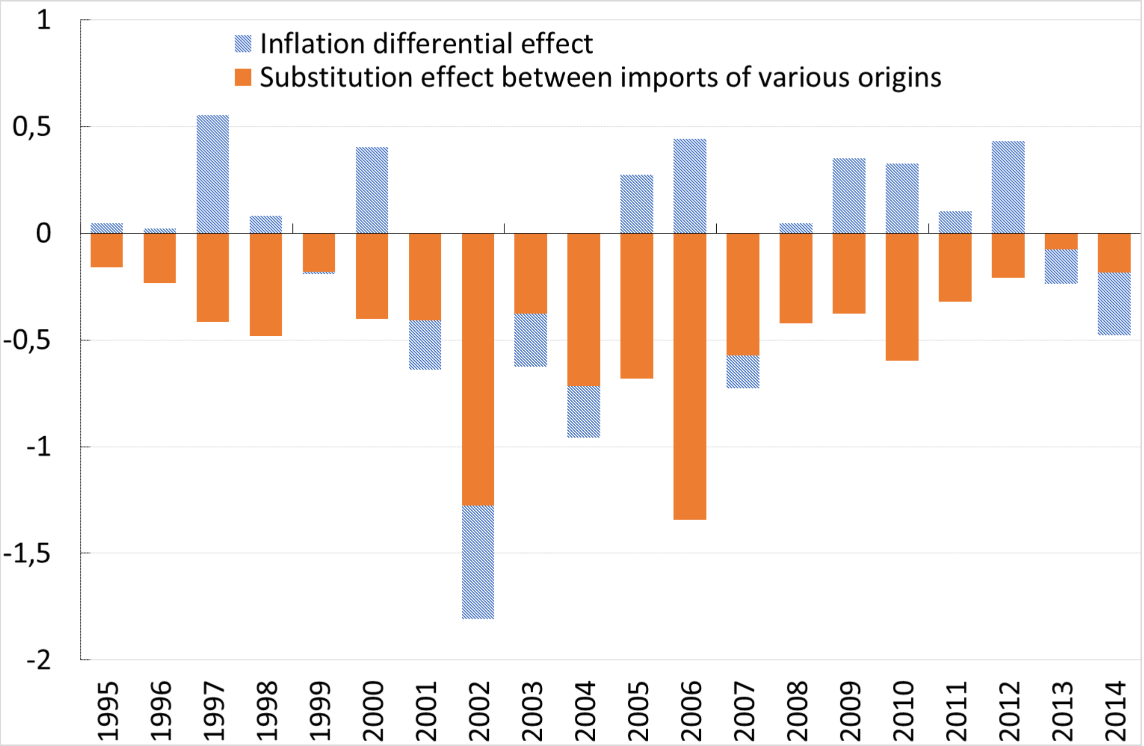
Source : Carluccio et al. (2018) based on Customs and INSEE data

Low-wage countries exerted downward pressure on imported inflation

For a given level of imports, the structure by import origin changed in favour of low-wage countries. The share of "rich" countries in imports fell from 76% in 1994 to less than 58% in 2014, while that of China increased threefold over the period, surging from 7% to 21%.

This change impacts imported inflation through two channels: (1) the substitution of cheaper imports from low-wage countries for imports from rich countries and (2) the inflation differential between prices of low-wage countries and other import prices.

Chart 3: Contribution of the substitution and inflation differential effects on imported inflation



Source: Carluccio et al. (2018) based on Customs and INSEE data

Chart 3 represents the observed contribution of these two effects to imported inflation. The inflation differential effect is slightly positive over the period (+ 0.06pp), while the substitution effect is negative (-0.47pp). Even though prices of imported goods from low-wage countries record slightly faster growth than other import prices, their level remains significantly lower. Thus, when they replace other goods in imports, imported inflation falls. Ultimately, through this channel imported inflation dropped by -0.4 pp per year, and CPI inflation by -0.06 pp per year on average.

The response of French companies to this heightened competition

Faced with competitive pressures, French companies adapt their pricing strategy. Assuming the cost structure remains constant, they can cut their margins to lower their prices and preserve their market share. This channel poses measurement problems as it is difficult to identify domestic price changes triggered solely by the shock of competition from low-wage countries. For example, price changes may also stem from a rise in domestic demand, which not only generates import growth but also exerts upward pressure on prices charged by French firms. The price decrease attributable to competitive pressure may then be underestimated because the demand effect plays in the opposite direction. By correcting these problems to capture solely the price response to the import shock, a 1% rise in the share of low-wage countries in the French market leads to a decline of around 1 pp in PPI inflation, and hence a drop of 0.06 pp per year on CPI inflation.

Lower prices but an overall effect that is difficult to measure

In 2014, households' consumption of goods and services amounted to around EUR 1,000 billion. Having access to cheaper goods enabled households to save about EUR 30 billion on consumption in 2014 compared to what they would have paid in the absence of international trade openness to low-wage countries. Taking into account the total number of households (slightly less than 30 million in 2014), consumption per household was therefore on average EUR 1,000 cheaper in 2014 compared to what it would have been in the absence of imports from low-wage countries since 1994.

These estimates are at the lower end of the range of the total direct effect on prices because they do not take into account the effects of imported intermediate goods incorporated into goods manufactured in France. The productivity gains associated with these inputs benefits French consumers (see Blaum *et al., 2016*).

These results are nevertheless to be interpreted with caution since the greater openness to international trade has also had indirect effects, in particular on wages (see Carluccio *et al.*, 2016) and employment (see Malgouyres, 2018). These effects should be taken into account when assessing the impact on households' purchasing power.