

## Linkages Between Chinese and Indian Economies and American Real Estate Markets

*Like everything else,  
the real estate market  
is affected by global forces.*

**IN THE 2004** presidential campaign, Democratic candidates have frequently blamed a big share of our current slow job recovery upon losses of American manufacturing and service jobs to foreign nations, especially China and India. However, few politicians of either party have recognized the immense positive impacts of the modernizing labor forces of those two nations upon American real estate markets—especially for homeownership.

No doubt the U.S. economy has lost manufacturing jobs to foreign producers over the past two decades, especially in the 1990s. But such losses are part of a much longer-term trend. U.S. manufac-

**ANTHONY DOWNS**

turing jobs reached a modern peak of 21.0 million in 1979. In the 24 years from then to the end of 2003, such employment fell in 16 years and rose in only 8 years, sustaining an overall loss of 7.1 million jobs (33.8 percent) to 14.3 million. But most of this loss came from improved productivity in our own manufacturing sector, rather than shifts of jobs overseas. Even so, the United States has undoubtedly seen many manufacturing jobs move to low-wage plants abroad.

This loss in U.S. manufacturing jobs has partly resulted from the modernization of China and, to a lesser extent, of India. This can be seen from an admittedly crude calculation concerning the world's industrialized labor force. There are about 6.4 billion people in the world, of whom 1.2 billion are in China and 1.0 billion in India. Assuming that one-fourth of Chinese and one-fifth of Indians are in the modern labor force, these two workforces account for 500 million people. There are approximately 4.2 billion other people in the world, of whom 800 million are in Africa, which is mostly outside the modern world economy. That leaves 3.4 billion world residents excluding China, India, and Africa, of whom, say, half, or 1.7 billion, are in the modernized world labor force. When China's and India's 500 million current workers enter that labor force, they represent almost a 30 percent increase in the

world's modern workforce—at relatively low wages.

This huge increase in the modernized labor force has restrained wage growth in industrialized nations and prevented manufacturers and other firms there from being able to raise prices. Wal-Mart's success illustrates this phenomenon, since Wal-Mart is able to undercut most other retailers in part because it is a substantial China importer. So labor force modernization by China and India has been a major force keeping inflation low throughout the industrialized world, including America and Western Europe. That has been a key factor permitting the world's central banks and banking systems to keep interest rates low.

#### GLOBAL BOOM

Thus, ironically, housing's recent worldwide boom owes a great deal to the impact of Chinese and Indian low-wage workers on the world economy. The United States has lost 2.7 million manufacturing jobs since 1994, many to China and other countries. But since 1994, we have also added 1.8 million jobs in construction and 1.1 million in finance, plus an additional 2.2 million in leisure and hospitality and 1.5 million in retail trade—all partly related to relatively low interest rates and stable prices.

America's recent housing boom, including strong new construction, immense refinancing of home mortgages, and a great run-up in existing and new home prices, is primarily attributable to the low interest rates made possible by dormant world inflation. Millions of American households, many of whom are complaining about losing service jobs to China and India, have realized trillions of dollars of capital gains because of rising home prices. However, almost no one recognizes the key role that the entry of tens of millions of low-wage foreign workers into the world's modern workforce has played in generating this immense increase in American household wealth.

One measure of this increase in American wealth is derived from the movement of U.S. housing prices over the past few years. In 1989, the total value of all owner-occupied housing in the United States reported by the 1990 Census was about \$5.0 trillion. The median value of single-family homes sold in the United States in 1989 was estimated by the National Association of Realtors to be \$89,500. By 1999, that number had risen 48.6 percent, to \$133,300. As measured in the 2000 Census, the total value of a larger number of owner-occupied units as of 1999 had risen to \$8.7 trillion, or by 74 percent over 1989. By June 2004, the median value of single-family homes sold in the United States had risen to

\$183,600, or by 37.7 percent over its value in 1999. If the total value of the still larger number of owner-occupied homes existing in 2004 rose by the same percentage, it would mean aggregate home values of \$11.9 trillion in mid-2004 (not counting mortgages or other debts against this total.) That is a gross increase in homeowner wealth of \$3.2 trillion in five years, compared to the increase of \$3.7 trillion in all of the 1990s. (Both figures are in current dollars. In 2004 dollars using the Consumer Price Index as a deflator, these increases would be \$2.26 trillion from 1989 to 1999, and \$2.01 trillion from 1999 to 2004.)

This estimate is confirmed by data from the Federal Reserve's Flow of Funds Accounts of the United States of June 10, 2004, which show that residential real estate assets on the balance sheet of all U.S. households combined (in current dollars) rose from \$6.476 trillion in 1990, to \$11.268 trillion in 2000—a gain of 74 percent—and then to \$14.989 trillion in 2003, up another 33 percent over 2000, and 131 percent over 1990. These figures are somewhat higher than the ones stated earlier because they include second homes and apartments owned by households. In the same 13 years that households' residential real estate gained \$8.513 trillion, household ownership of corporate equities and mutual fund shares combined first rose \$8.312 trillion from 1990 to 2000,

then fell \$1.483 trillion from 2000 to 2003, for a net gain of \$6.828 trillion. That was 18 percent smaller than the net gain in residential real estate. Though stock values increased from 2003 to 2004, home values rose by more.

#### FUTURE SHOCK?

But what will happen in the future? Today China is growing so fast that it is absorbing enough commodities so that world commodity prices have begun rising. Yet many of the millions of Chinese and Indian and other Asian workers have yet to join the modern world economy. As they do, they will continue to exert a leveling impact upon world wages and prices. On the other hand, as they consume more, those workers will raise demands for goods such as petroleum and food, thereby exerting a positive impact upon inflation. But net, I do not believe the world is in for as inflationary a period as it experienced right after World War II.

The long period of low inflation in the 1990s also affected non-residential real estate markets by reducing interest rates and increasing world monetary liquidity. In the late 1980s, there was a boom in real estate development in the United States, followed by the crash in 1990 that slashed both rents and property prices. Then non-residential property markets gradually

recovered in the mid-to-late 1990s along with the United States' strong general economic expansion. This recovery was aided by a substantial shift of non-residential and apartment property ownership into real estate investment trusts (REITs) funded through the stock market.

When the Internet and high-tech stock "bubble" burst in 2000, most stocks plunged. But the best REIT stocks began a rapid climb in value as institutional and individual investors rotated into real estate. At the same time, real property prices in private markets stabilized and even rose, although the underlying fundamentals of occupancy rates and rents were deteriorating as the economy weakened. This resulted in the paradox of strong demands for the ownership of property at the same time as the demands for its occupancy were declining.

We are entering a period of general global economic expansion in which interest rates are likely to rise, or at least to stop falling, ending their long secular decline from their peak in 1982. True, the deflationary impact of the entry of millions of low-wage foreign workers into the world's modernized labor force will probably prevent a return to the days of rapid inflation in the mid-20th century. But the shift to even gradually rising interest rates should cool off the intense boom in housing prices and mortgage refinance that has dominated single-family residential mar-

kets for several years—and sucked tenants out of apartments.

mal” conditions in both housing and non-residential property markets in the near future.

## CONCLUSION

Whether American households’ notable gain in real estate wealth since 1990 will be somewhat counteracted by a future decline in home prices is unclear. As interest rates rise, some decline in housing prices in overheated condominium markets like those in South Florida and Las Vegas seems likely. And the values of the highest-priced single-family homes could also drop somewhat in many areas. But a major across-the-board roll-back in housing prices throughout America seems unlikely. The annual U.S. median home price, in current dollars, did not fall even once from 1968 to the present, which included several significant general economic recessions.

Also, if the current general economic expansion lasts long enough, it should stimulate greater space demands for non-residential property. This will help offset the negative impact of rising interest rates on the profitability of such property. One of the reasons interest rates will go up will be rising demands for non-real-estate capital from expanding businesses. That should help reduce the excessive liquidity that kept property prices from falling along with demands for space after 2000. Perhaps we are therefore in for more “nor-

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