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## The China syndrome

Investments flow into country with a population of 1.3 billion

By Philip Newswanger

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That giant sucking sound is China, inhaling dollars and euros that might have ended up in America's cities and states as jobs, production lines and properties.

But China insiders warn that China is less a Holy Grail than a Holy Hell.

Investors, from automakers to retailers, poured \$60.6 billion into China in 2004, up 14 percent from the previous year, with companies pledging another \$153 billion this year, making this country with a 1.3 billion population second only to the United States as a recipient of direct investment.

Actually, the number may be higher as figures on debt, unemployment and foreign-directed investment are under-reported, both by provincial governments and foreign investors, to avoid taxes and government scrutiny.

Usha C.V. Haley, professor of management at the University of New Haven in Connecticut and co-author of *The Chinese Tao of Business: The Logic of Successful Business Strategy*, estimates that \$30 billion of "hot" money, or unauthorized foreign currency, may have entered the country last year.

"China's porous capital controls allow investors from all over Asia to bet on a currency revaluation by buying property in Shanghai or Beijing or putting their money into high-interest yuan," Haley said.

(The yuan, or remimbi, is known as the "people's currency"; the 100-yuan note is imprinted with Mao Tse-tung's portrait.)

Some companies turn a profit. Others flee after a year or so.

"Going to China doesn't necessarily mean that you make a profit," Haley said. "Seventy percent of them never make a profit."

But furniture and textile production will never return to the United States.

"The jobs that have been lost have been lost forever," she said.

Bonnie Girard, head of China Channel Limited, a consulting firm with offices in Richmond and Beijing, sees China as a threat to state and local developers trying to attract direct investment.

"The threat is well-organized, well-planned and state-sponsored from the highest levels of the Chinese government," Girard said. China's strategy to attract foreign investment in the early 1970s is now in full swing, Girard said.

Barraged by the government-controlled media, the Chinese people have come to believe that foreign investment is indispensable to its economic future, Girard said.

"As a result, the Chinese people live, breathe and eat the concept of economic development, and its necessary adjunct, foreign investment and foreign technology," Girard said. "Strong believers make strong advocates."

The U.S. has no strategic policy. Hard-pressed for jobs and long-term tax revenue, states and cities pursue their own economic-development policies, often to each other's detriment.

Last year, the Chinese government deemed that the steel and auto industries were strategic and heavily subsidized both industries.

So Chinese banks made cheap loans and car sales reached 2.3 million units in 2004, almost double sales in 2002. But China-based automakers sold only 300,000 more units last year than in the previous year. In response, automakers cut production and prices have dropped by 20 percent, Haley said.

BMW's sales in China tripled in 2003 when banks made cheap loans, according to Haley, but the German automaker said it cut its prices by 50 percent as sales fell and inventory ballooned.

Automakers in China have unsold inventory of 500,000 units. Yet car production is forecast at 10 percent more than last year and 25 of China's 31 provinces are vying for car plants and cutting their own deals with foreign companies outside of the normal bureaucratic channels.

"The hills are high and the emperor is far away," Haley said, quoting a Chinese proverb.

Haley provides these examples of how U.S. and European companies grossly underestimate the size of the market and suffer for it in depressed prices.

Cheap wages are viewed widely as the reason why many companies set up operations in China. But foreign companies also get free land, free utilities and privileged access to raw materials, Haley said.

Furthermore, China bans labor unions that aren't sponsored or run by the government, an attractive selling point to many international companies, Girard said.

"China effectively has one labor union under the supervision of the government and the party," Girard said. "The union representative at ground level is often a member of management, and union activity on behalf of the worker is generally focused on providing him with social events and dealing with mostly innocuous aspects of his working life."

Wage and benefit negotiations, collective bargaining and strikes are immediately suppressed, Girard said.

"A lot of U.S. and European companies are not at all adverse to this kind of business environment," Girard said.

Many companies arrived in China over the past 20 years believing that investment was the path to the Chinese consumer, Girard said.

"Some made it; most did not," she said.

Disillusioned by the elusive Chinese consumer, companies shut down and left the country.

"The market doesn't exist," Haley said. "It's a mirage."

Those who stayed benefited from cheap manufacturing, hoping that their presence in China would someday lead to 1.3 billion consumers. Meanwhile they geared up to export.

"But few companies come without that 1.3 billion number in their minds, and that Holy Grail of a number is one that the U.S. just can't quite match," Girard said.

Haley said many companies are drawn to China because of a lemming mentality: If one goes, the rest will follow.

"Enormous downward pressure on prices, especially in manufacturing, as well as fear of losing potential markets in China to rivals spurs foreign companies to rush to China often without a good understanding of the problems their operations will face in that country or the markets for their products," Haley said.

But foreign companies are the base of China's export machine and economic miracle, Haley said.

"Almost all Chinese exports occur through foreign companies," Haley said. "These companies provide jobs, capital, technology and managerial know-how, among other benefits to China."

Girard said western businesspeople are attracted by the challenge, the difference, the mystique, the difficulty and even the dark side of what they know about China.

"Charm isn't always a bright and sunny quality," Girard said. "There is a subjective aspect to the investment decisions that are made here, an aspect that influences even the most seasoned of internationalists."

"In a choice between Shanghai or Tulsa, where would you like to be first?" Girard said.

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