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Like Japan in the 1980's, China Poses Big Economic Challenge

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GUANGZHOU, China - When Japan, at the zenith of its economic power, built a huge airport in Osaka in the late 1980's, the project set off a seven-year trade battle with the United States over the nearly complete exclusion of non-Japanese companies.

China, Japan's heir as Asia's rising star, is now completing its own immense airport here in Guangzhou, the sprawling commercial center of affluent southeastern China. But the Chinese are going about it differently.

American companies designed the terminal, its air-conditioning system and the flight information system. A German company engineered the vaulting roof, a Danish company produced the boarding gates and a Dutch company, the check-in counters. Chinese women in broad-brimmed straw hats wield shovels and brooms across from a modern air-traffic-control tower designed by a company from Singapore.

The welcome that China is offering to multinational companies and foreign investment has left many Western business executives, so critical of a closed Japan more than a decade ago, enthusiastically embracing China, its cheap work force and its huge markets.

But that same openness - combined with China's vast population of 1.3 billion and military muscle - makes it an even greater long-term economic challenge to the United States than Japan seemed to be in the 1980's, according to a growing number of executives, economists and officials.

While China's economy is still one-third the size of Japan's, the potential size of its market has made it very hard for companies to say no when Beijing officials demand that they build factories, transfer the latest technology or adopt Chinese technical standards.

Japan has effectively run out of low-wage workers for its industries, and quickly brought much of its economy up to and in some cases beyond Western technological standards. China still has vast reserves of cheap labor in inland areas and many backward industries that can grow swiftly as they copy Western and Japanese methods.

"China could do what Japan did, as a very fast follower, but China could do it bigger and better and for a longer period of time," said Steven Weber, an Asia scholar at the University of California at Berkeley. "It's not necessarily as vulnerable as Japan was."

But while Japan's danger to other economies over the last decade has taken the numbing forms of economic stagnation and political lassitude, China poses the risk of fast, sharp shocks.

Its transition from a planned economy to a form of capitalism seems to make it especially susceptible to economic booms and busts, and Chinese officials have begun worrying that an unsustainable economic bubble is developing. At the same time, China's one-party system may struggle to adapt to the social tensions brought to the surface by rapid economic development.

Optimists see it surmounting such obstacles. "Once China passes the high growth, it will have the bursting of the bubble," said Eisuke Sakakibara, Japan's former vice minister of finance for international affairs, "but that will happen in 20 years. China is Japan of the 1960's."

Others express greater caution. David Cunningham, the president of Asian and Pacific operations at Fed-Ex, said the company was considering the new Guangzhou airport as the site of an Asian hub, somewhat like its huge operations in Memphis. But FedEx is watching China's growth carefully.

"What could be devastating is if the global business-investing person becomes burned or disillusioned and takes their investment elsewhere, and today it can happen at the click of a finger; ask Southeast Asia about it," Mr. Cunningham said, referring to the Asian financial crisis of 1997-98, from which the region is still recovering.

Like the Japanese challenge of a generation ago, China's strength is drawing growing attention in American politics. Senator John Edwards of North Carolina has become the main challenger to Senator John Kerry of Massachusetts for the Democratic presidential nomination by emphasizing jobs lost to trade, especially trade with China; Mr. Kerry says he and Mr. Edwards essentially agree on trade questions.

The Bush administration over the last year has tried to assuage worries about job losses by talking tough with the Chinese - in particular, demanding that China let the exchange value of its currency float upward to raise the price of its exports. But it has also continued to assert its faith in a policy of free trade.

China's strengths are indeed impressive. Its wage advantage is much greater than Japan's was a decade or two ago. China has the diplomatic muscle to resist trade and currency concessions that might undermine its competitive edge. And its opening to foreign investment brings China both the latest technology and the corporate connections overseas that help it fight restrictions on its exports.

For all these reasons, China's trade surplus with the United States has soared, quintupling in the last decade to \$124 billion in 2003. By comparison, Japan's surplus did not quite triple in the decade when its economy conjured the most anxiety among Americans. And in the last decade, it has leveled off, at \$66 billion last year.

China's biggest competitive advantage, its immense and low-paid work force, is on view here in the southeast, at places like the BBK Electronics Corporation's air-conditioned factory in Dongguan, a two-hour drive from the new Guangzhou airport.

Sun Xin, 20, is one of nearly 4,000 employees, most sitting on backless stools at long counters under fluorescent lights, as they snap and screw together fairly sophisticated portable and countertop DVD players. Wearing a blue company baseball hat and a blue company-issued shirt, she works 8 to 11 hours a day stuffing power cords, remote controls and other DVD accessories into plastic bags.

Du Anan, an identically dressed 18-year-old on the other side of the counter, then tapes the bags shut.

Like most of the workers, Ms. Sun and Ms. Du are migrants, having each taken a 30-hour ride aboard slow Chinese trains from their impoverished villages in north central China. Each earns \$60 to \$75 a month, a pittance by American standards but a lot in rural China, where 200 million people live on less than \$1 a day.

"There is nothing to do at home," Ms. Sun said. "I came here to learn to do more myself."

She and Ms. Du live in factory dormitories and say they rarely venture out. But the women express the same excitement, in almost the same words, about having come even to a grimy, smoggy city like Dongguan. "I want to see the outside world," Ms. Du said.

China has 10 times the population of Japan, with more unemployed adults in rural areas than the entire American work force. Raising the wages of so many people to the levels found in industrial nations will take a long time.

Through the 1970's and 80's, Japanese wages rose 70 percent faster than American wages, according to data from the International Labor Organization. That, together with rapid appreciation in the value of the yen, helped push up Japanese factory wages from one-third of American levels to rough parity.

Chinese wages, though, were no more than 4 percent of American and Japanese wages in 2002, the most recent year available. While official Chinese statistics show that wages doubled from 1996 to 2002, some factory owners say pay has been flat - or even declined slightly - in recent years, as rural migrants continue to pour into the cities.

In the meantime, China's productivity gap is being closed by a rapid investment in infrastructure, as China puts a third of the world's steel production and half its cement into extending modern roads, power grids and telecommunications links across the country.

BBK Electronics is an example of how China has benefited from opening up to the global economy. Money from Taiwan and Russia, as well as local Chinese money, helped build the company's factory seven years ago, said Louis Leung, the marketing manager, and BBK now makes many devices sold in the United States under the Memorex, Philco and Lafayette brand names.

If Japan profited handsomely from selling videocassette recorders two decades ago, China is coming to dominate the production of the next generation of DVD technology. BBK started by licensing technology from Sony, but it now has 300 researchers coming up with refinements, Mr. Leung said. On a laptop computer, he plays a company presentation that ends with BBK's two long-term goals: "to realize modernization" and "to challenge Sony."

Japan rapidly caught up with the West by licensing technology from companies like Caterpillar that failed to foresee the risk of Japanese competitors like Komatsu. But China has both licensed technology and used the attraction of its potentially huge market to lure foreign investment.

That has not only brought further investment but until recently has also helped insulate China from trade clashes. Many of the same multinationals that once fought with the Japanese, like the Detroit automakers, are now big investors in China - investors that oppose trade restrictions on it.

But as the Chinese work to build industrial cornerstones like the auto and semiconductor industries, this may change. Nor has China avoided some trade conflicts. Executives in many industries describe China as more open to imports than Japan, but still not nearly so open as the United States. From soybeans to commercial banking, American businesses complain that China has thrown up regulatory barriers that limit their ability to compete.

Daryl Hatano, vice president for public policy at the Semiconductor Industry Association in San Jose, Calif., said his group might ask Washington to file a protest with the World Trade Organization if China did not halt its practice of charging taxes as low as 3 percent for domestically produced computer chips, compared with 17 percent for imported chips.

Even with those taxes, imported chips hold 85 percent of the Chinese market; by comparison, it took tense negotiations in 1986 for President Ronald Reagan's administration to win an agreement giving American manufacturers a goal of 20 percent of the Japanese market; by 1995, the sales rose to 30 percent.

So far, the Bush administration has limited its Chinese trade cases to fairly small categories of exports like brassieres, a few kinds of furniture and color television sets.

In part, analysts say, Washington chooses to act gingerly out of geopolitical considerations. China is a nuclear power that, unlike Japan, does not depend on the United States for military protection. Yet the United States looks to Beijing for help in coping with problems in countries including North Korea, Pakistan and Afghanistan. So while American officials, for example, can press the Chinese to let the yuan float, they cannot press as hard as they did with Japan in 1986, when Tokyo was spurred into letting its currency rise sharply against the dollar, eroding the competitiveness of Japanese exports.

"Washington is concerned about China setting its own agenda," said John S. Chen, the Hong Kong-born chairman and chief executive of Sybase, an American software company that has expanded aggressively in both Japan and China. "The Japanese were more friendly."

The biggest question lingering over China is how vulnerable it remains to acute setbacks - a banking failure, an inflationary spiral, even a temporary economic bust. Citing overcapacity and excessive investment in some sectors of the economy, the Chinese central bank warned recently that "we really cannot be optimistic about the situation of inflation." A crack in the economy could shake governments across East Asia that have tied their economies to China's, warns Ajay Kapur, a strategist in Hong Kong with Salomon Smith Barney.

For a parable about economies that seem as if they could prosper indefinitely, Chinese officials need look no farther than to Osaka and its huge airport. The artificial island on which it was built a few years ago is slowly sinking in the Pacific.

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