



## A Perfect View of Imperfect China in the Eyes of a Rep

**C**hina's rise is no longer a prediction. They are already the world's fastest growing economy. The U.S. has passed that golden baton to China and the Dragon is in a sprint. The question is, "How long will the U.S. and China be in the race and, more importantly, where will we finish?" Some observers feel that the U.S. has developed a severe case of cramps and we need a serious injection of good financial medicine. Does it make sense to concede economic leadership to China? I don't think so, and this article explains the reasons why.

Make no mistake about the power and ferocity of the Dragon. The trade deficit worries many western politicians and it is only getting worse. How do we get it back in balance? Can we? Should our government try? I think so, or our day as the world's dominant economic power will soon be over. It's bad enough that our country is the largest debtor nation with the most debtor corporations and indebted people

There is also a growing concern among American critics that the sinister hand of the Chinese state may someday wrench control of U.S. assets and markets. This was illustrated in the attempt of Chinese companies, CNOOC and Haier, to acquire Unocal and Maytag. The obvious fear is because a socialist/communist state lurks behind Chinese companies. Some believe that this concern is perfectly logical and, apparently, so does Congress. However, America should acknowledge that our own economic growth was fueled by overseas expansion.

Are we hypocritical? Probably. What's wrong with acquiring resources, technology and distribution channels for the purpose of generating higher GDP's?

In case you forgot, Lenovo bought IBM's PC business, TCL took over France's Thomson TV business and China National Petroleum Corp. bought Canada's PetroKazakhstan for its oil fields. Hold on folks; more is coming, lots more!

### Size Matters

Size is the reason that China fuels the American imagination. This is a country with four times the population of the U.S. For over 100 years, it was dreams of this magnitude that fascinated groups of American missionaries and businessmen – one billion souls to save, two billion armpits to deodorize. But it never amounted to anything. China was very big, but very poor. All of this is changing and the very size and scale of China is beginning to look both alluring and ominous. Americans are wondering whether the "China threat" is nightmarishly real.

### What Are Your Perceptions?

Today, nearly every businessman has a dazzling statistic about China meant to stun the listener, and I am no exception-China is mind-boggling. As an example, over the past 15 years

China exports have grown 1600% compared to U.S. growth of 415%, but that statistic conveys the depth and breadth of the challenge the U.S. faces.

Every year, Intel sponsors a Science & Engineering Fair, which is the world's largest pre-college science competition open to high school students around the world. Last year was a good one for Americans – 65,000 participated in local fairs that are used to select finalists. In China, the number was an astounding 6 million.

### Reasons for China's Edges

There are perfectly good reasons why China has made a quantum leap compared to the rest of the world's countries – some good, some bad, and some downright unethical. Success started when this communist country was admitted to the WTO (World Trade Organization) with few caveats, such as allowing them to peg their currency (yuan) against the dollar and utilize sweat shop labor. Human rights are still an issue in this totalitarian government. But the biggest reason of all is that America fueled China's economy by investing hundreds of billions of

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dollars to build high-tech factories, stuffed with the industrious, low paid Chinese workers. Will it last forever? Absolutely not! But in the meantime, the rush is still on to enhance profits with what Lou Dobbs calls "labor-rate racketeering". Corporate board members and shareholders are demanding it. But many economists feel that China is only the first step and that a BRICK foundation is being laid throughout the world. Incidentally, BRICK is an acronym that stands for: Brazil, Russia, India, China and Korea.

### Listing China Resources

These can be viewed either positively or negatively. You be the judge.

- **1.3 Billion People:** (Plus) A huge and cheap labor pool. (Minus) Lots of mouths to feed, brains to educate, and bodies to medicate. The question: Will the Red Capitalists channel the money to the peasants?

- **Economic Growth:** (Plus) 9.3%, three times the U.S. They have the 25 years of consecutive +9% growth and the power of our Fortune 500 companies behind them. (Minus) U.S. companies will probably seek bastions of lower labor rates in English-speaking countries, like India. The question: How long can China stay economically attractive without currency manipulation?

- **Gross Domestic Product (GDP):** (Plus) Approximately \$7 trillion. (Minus) This will fuel inflation, as lifestyles begin to rival the western world. China already has more millionaires than the U.S. – believe it! The question: Can China sustain its growth while competing with the rest of the world for higher-priced energy and materials? China is the world's largest producer of coal, but other countries have more cost effective oil and nuclear power.

- **Investment in U.S. Treasury Notes:** (Plus) Good for U.S. (Minus) At the rate the value of the dollar is dropping, it could be a bad investment. The question: Can the U.S. stay strong if we have to depend on Communist China for foreign investment and loans to rebuild New Orleans after Hurricane Katrina? China is the second largest owner of T notes at approximately \$180 billion. Is it good that China is a major stakeholder in America? Maybe so, but I would rather see our own citizens have the money to buy U.S. securities. I believe that it would make our country more secure and independent.

### Semi Smarts

China aspires to be a technology leader in semiconductors and just took a brilliant step to achieve that goal. For the first time in academia, they have developed a curriculum in semiconductor technology. This is not your typical EE or computer science stuff, but a course dedicated to advanced designers, fabrication and manufacturing of IC's. Watch out Intel, AMD and TI, the Chinese are coming! I almost forgot to mention that they are in the midst of developing the world's fastest super computer and have an ex-Cray genius in their corner and, yes, he is Chinese.

### Where is China Headed?

Can China maintain a totalitarian style of communism, grow their military, and still stay friends with the U.S.? Personally, I don't think so. They may stay friends with corporate America – they have to (for now). But, politically, it may be a different story. As they dominate the Asian economy, they've been prone to flexing their military muscles. Will America and Eastern Europe condone and patronize a bully? Will China back off their demands that Taiwan is theirs, or will it be a bone of contention and a potential breaking point? In an article by Joseph Kahn in The New York Times – Chinese General Threatens Use of A-Bombs if US Intrudes – a senior Chinese military official was quoted as saying, "China should use nuclear weapons against the United States if the American military intervenes in any conflict over Taiwan."

In the words of a well-known business consultant, "If China can't drop a bomb on us, they will take away our manufacturing base, because it is the catalyst for the entire U.S. economy." Right now, our country is awash with old, decrepit manufacturing plants. Paradoxically, China is building all new facilities with new equipment, while consuming half of the world's oil and half of the world's steel and concrete. It would serve U.S. companies well to optimize their strengths and eliminate bottlenecks and waste that make for lost profits. America can compete if we simply improve our processes. The pursuit of efficiencies never ends. I strongly believe that, before our U.S. companies outsource to China, they should aggressively pursue lean manufacturing and other changes.

### Listing China Concerns

- **Air Pollution:** Reportedly some of the worst in the world.

- **Anti-American Propaganda:** Commonplace in the South China Times. How's that for American investment gratitude?

- **Human Rights:** Once away from the big cities, you remember that you're in a communist country, where freedoms and dignities are few.

- **Sickness:** Due to lack of disease control, you may contract maladies like bird flu, intestinal ailments. Remember SARS?

- **Disregard for IP:** If you can't afford to have patent infringement or theft of intellectual property, DON'T GO THERE! The Chinese are not dishonest people – let's just say that they are very aggressive.

- **Rising Labor Rates:** Low today, tomorrow maybe, but they are certain to increase.

- **Trade Imbalance:** China is now an indispensable trading partner and yet, the imbalance exceeds \$500 billion.

- **Time to Market (Money):** Can suppliers afford 4 to 6 weeks at sea and potential dock strikes? Logistically speaking, does Mexico or South America have more appeal-but at what price? Is post-Castro Cuba appealing? Many think so.

- **Communist Government:** Does the world really want to see China as the next global power? Some European countries do, and there are other factions that simply hate us. If we are going to be manufacturing and technology dependent on China, I seriously hope that we're the very best of friends.

- **Currency:** The yuan will eventually float without the existing 1.5% incremental constraint cap. WSJ now reports that consumer prices in China are on the rise and that the middle class is growing.

- **Military:** The PLA (Peoples Liberation Army) has the second largest military budget in the world to the U.S. and has the largest (2.5 million) standing army in history.

### The China Threat

Without question, the China threat looms largest for the U.S. Historically, when the world's leading power is

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challenged by a rising one, the two have a difficult relationship. While neither side will admit it publicly, both China and the U.S. worry and plan for trouble. This is not to assume war or even conflict, merely to note that there is likely to be growing tension between these two countries. How both sides handle it will determine their future relationships and the peace of the world.

### **Summary**

What we can do is be better prepared. This means a renewed focus on core skills that have propelled our economy, such as science and technology. The U.S. has slipped badly in all global rankings and fields. Our R & D facilities are dominated by foreign students and immigrants, but a growing number are staying home or going home. Without massive focus on these areas, America will find itself unable to produce the core of scientists, engineers and technicians who comprise the base of an advanced industrial economy. China and India already produce more engineers than the U.S. and in 5 years they will have more PHD's. The Chinese have unparalleled drive to be productive and an insatiable appetite for knowledge. It's anyone's guess where China vs USA is heading but, if you are a "trend watcher," the course is clear. China is on a roll and America is on a stroll.

A world war is highly unlikely. Nuclear deterrents, economic interdependence and globalization all weigh against it. Beneath the calm there may be a soft war, a quiet competition for power and influence around the globe. America and China will be friends one day, rivals another, cooperate in some areas and compete in others. Welcome to the global society and, as Thomas Friedman states, "The World is Flat." ■