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Inside China's Economy

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Inside China's Economy

Alexandra Harney

We hear so much about China in the news these days. Google has pulled its search engine out of China. American companies are complaining that Beijing is making it harder for them to do business there. We hear that China is stealing American jobs. It is selling us toxic drywall, poisonous pet food, and deadly drugs.

China is in the news for good reason. No other country is more important to our future.

China is at the beginning of a transition out of one economic model into another, away from relying on low-value-added exports and towards relying on domestic consumption, high-value-added exports and innovation to drive its economic growth. This transition has enormous implications for American companies and the global economy. To understand America's future, we must understand what is happening on the ground in China.

And to understand China, it is important to understand Chinese people. About a year ago, I visited a village in the eastern province of Jiangxi. At that time, there were about 23 million Chinese workers unemployed because of the financial crisis. The Chinese government – and even the U.S. government – was concerned that with so many people out of a job, China might tip into chaos. Workers would be angry at the Chinese government, and they would march and protest.

Out in the countryside, I asked unemployed factory and

construction workers the same question: Are you angry? They all looked at me like I was an idiot. The global financial crisis began in America, they said. The Chinese government did not cause this crisis, and it is doing its best to get us through it.

What I heard in their statements is a sentiment that has only strengthened since then. Many Chinese feel that the financial crisis proved the strength of their country's economic model and marked a turning point in its rise.

I believe that we will see more examples of what foreigners perceive as a stubborn attitude by Beijing on certain issues. This is evidence of a greater confidence by the Chinese government in its position on a range of issues. That confidence, and our high unemployment rate here in the United States, likely means that we are moving into a phase of greater tension on economic issues with China.

Given the close interdependence of our economies, we must carefully consider our approach to China during this period. One of the arguments we hear often in the news these days is that China's undervalued currency is putting Americans out of work. I respectfully disagree. Employment in manufacturing sectors in countries like Mexico, Indonesia and Thailand has been much harder hit by China than the United States.

Even if China decided to let the renminbi appreciate tomorrow, its factory jobs would not move to America. Why? For one thing, the entire supply chain for many products is in China. One town in southern China produces half of the world's microwaves. About an hour's drive away, another factory produces most of its iPods. Down the road is the world capital of faucets. The global watch capital. Everything you need to make these products is located within a two-hour drive. These groupings – also known as industrial clusters – are extremely competitive.

It would take years, and a significant increase in energy prices and protectionist policies, or a substantial decline in U.S. wages, to move these supply chains to America. China's advantage in certain industries is now so deep, so entrenched, those jobs are probably never coming back. China turned the Great Recession into the Great Opportunity. Its market share has gone from 15% before

the financial crisis to 19% after.

The second reason that those factory jobs are not coming back is because the biggest growth market for most companies is China. More companies will want to make products in China to serve the Chinese market. Appreciation of China's currency is not going to solve America's unemployment problem.

China no longer wants to be just a manufacturer of low-end consumer goods for several reasons. First, it knows that we are getting a better deal out of its factories than it is, by shifting our polluting jobs to China and leaving only a small profit margin with its factories. Second, it is running out of cheap labor. The workers in Chinese export factories grew up poor on farms in the countryside. This flood of people from the farms to the cities is the largest human migration the world has ever seen. But because of the one-child policy China introduced three decades ago, that flood is slowing.

To move up the value chain, China is increasing its spending on research and development faster than any other big country. American companies are also moving their research-and-development and product-design activities to China. Thirty percent of China's investment in high-tech research-and-development now comes from foreign companies. People often ask me whether China can innovate. My answer is that China is already innovating. And we are helping China do it.

In the next phase of China's development, it will focus on producing higher-value-added, less resource-intensive exports, doing more innovation and design locally, and building global brands. To do that, it will need more specialists in branding, human-resources management, product design and organizational change. This is an opportunity for American companies.

To take advantage of the transition underway in China, we need to stop blaming it for our own problems. China is a convenient foil for politicians, but the issues we are facing creating jobs after the recession are ours alone. The only way we are going to compete with – and profit from – a rising China is by first getting our own house in order. We have nothing to gain from protectionism.

Second, we need to make sure we keep attracting the best talent to our universities and companies, through immigration

policies that will help us build the next Google or General Motors.

Finally, we must invest more and more intelligently in education. There are now more Chinese people studying English in China than the entire population of the United States. As we enter a new phase of competition and cooperation with China, some of what we must do is the government's responsibility. But much of what we must do, we must do ourselves.

Alexandra Harney is the author of The China Price: The True Cost of Chinese Competitive Advantage (2008). She also serves as a Visiting Scholar at the Center for Asian Studies at the University of Hong Kong and the Director of Research for Visibility Media. Harney previously served as the South China Correspondent for The Financial Times and was a Visiting Fellow at the Hong Kong Institute of Economics and Business Strategy. She is also a member of the Global Perspectives Office's Internationalization Advisory Board.