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Chinese development;
trends, risks and impact on other countries

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Reasons behind the establishment

- Underestimation of the impact of Chinese growth on the European economy
- Dutch (and European) companies are not active enough in China
- Need for information, advice and help



China's development: a mixed picture

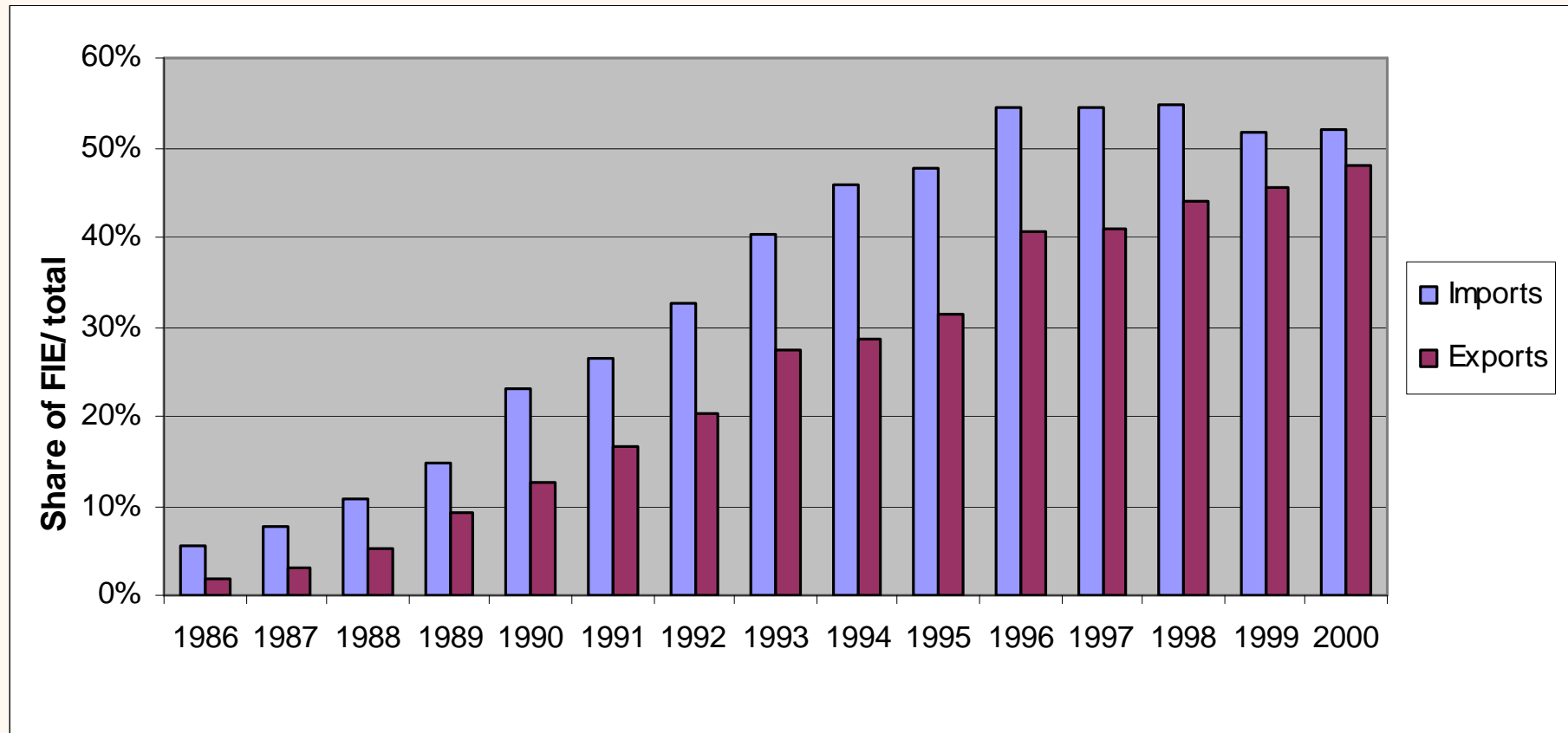
China's visibility (2005)

- 64 percent of clothing sector in the US is “made in China”
- Increasing dependency: TNT, Nokia, Toyota, Motorola, Kodak etc..
- More and more R&D facilities in China: Philips, Intel en Siemens
- 16 out of 20 most polluted cities are in China (WorldBank)
- 35% of the world demand for steel, coal and iron comes from China; increase in commodity prices
- Chinese brands are coming: Landwind, Haier,Lenovo,TCL,Huawei etc.

Structure

- Long term development of China
- Short term growth forecasts and drivers behind growth; explaining success
- Macro economic risks
- Speed of changes and its impact on the Netherlands

China: Share of foreign multinational enterprises



Newest data (2004): 56% (X) and 55% (M)

Strong connection between trade and FDI

Wal-Mart's A Big Factor

- In 2004, Wal-Mart imported more than \$18 billion from China – more than 10% of US trade deficit with China is now attributable to Wal-Mart.
- If Wal-Mart were a country, it would rank as China's 8th-biggest trading partner – putting it ahead of Russia, Australia and Canada.

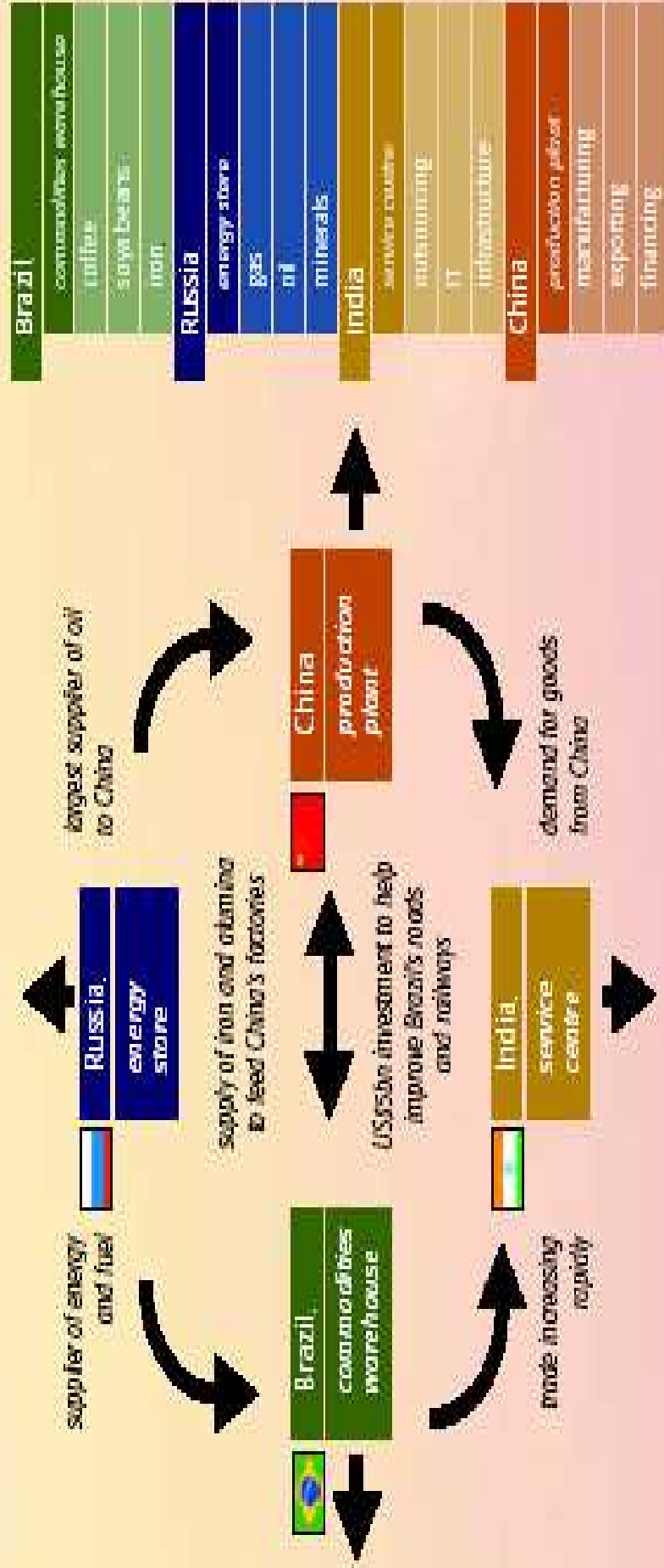
BRIC (Goldman Sachs, 2003)

- In less than 40 years, the BRICs' economies together will be larger than the G6 in US dollar terms.
- The BRICs will become the main source of new global spending in the not too distant future.
- They are the new economic locomotives in the near future

The big assumption underlying all the projections is that the BRICs maintain growth-supportive policy settings.

2,716,111,303 reasons why BRICs are the future....

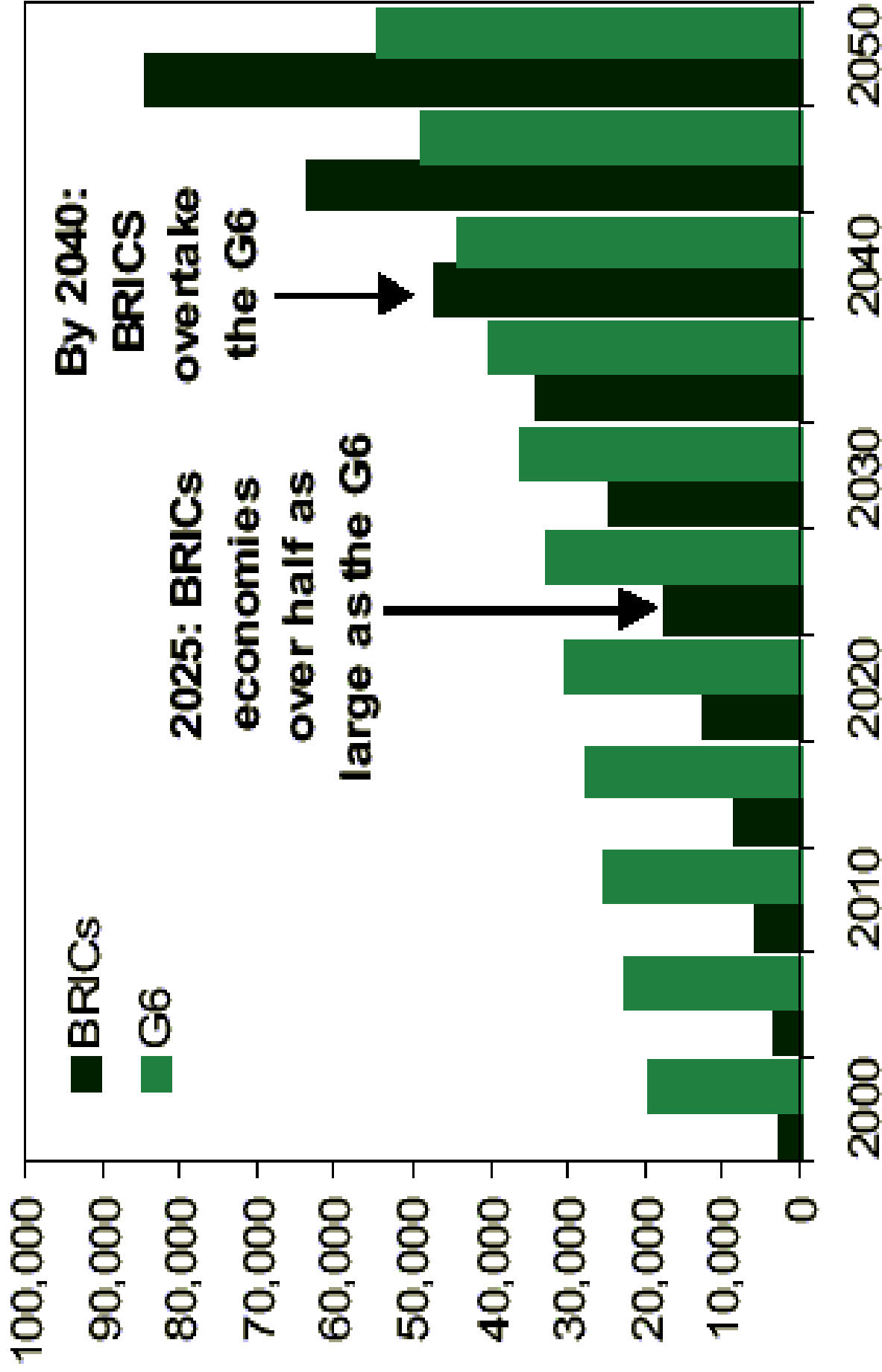
That's the combined population of the four BRIC nations - more than 42% of the world's total'. All of the BRIC countries are uniting together on trade and industry and whilst each has its own independent investment attractions, it is the synergies between the countries that are grabbing the attention of the rest of the world.



BRICs Have a Larger US\$GDP Than the G6 in Less Than 40 Years

GDP

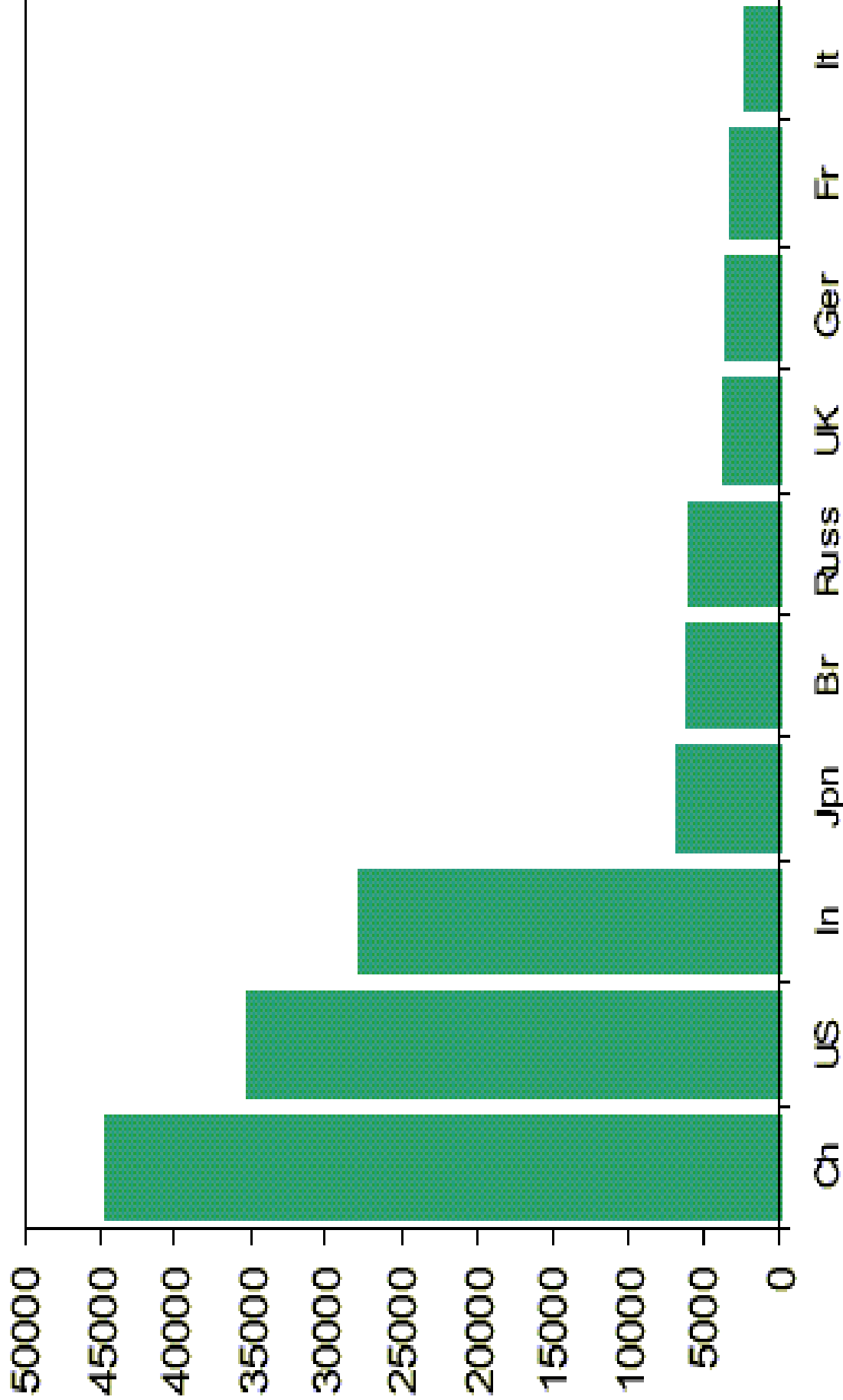
(2003 US\$bn)



GDP

The Largest Economies in 2050

(2003 US\$bn)



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China's Income Per Capita Growing Share of US Income Per Capita

2003

US\$bn

140,000

120,000

100,000

80,000

60,000

40,000

20,000

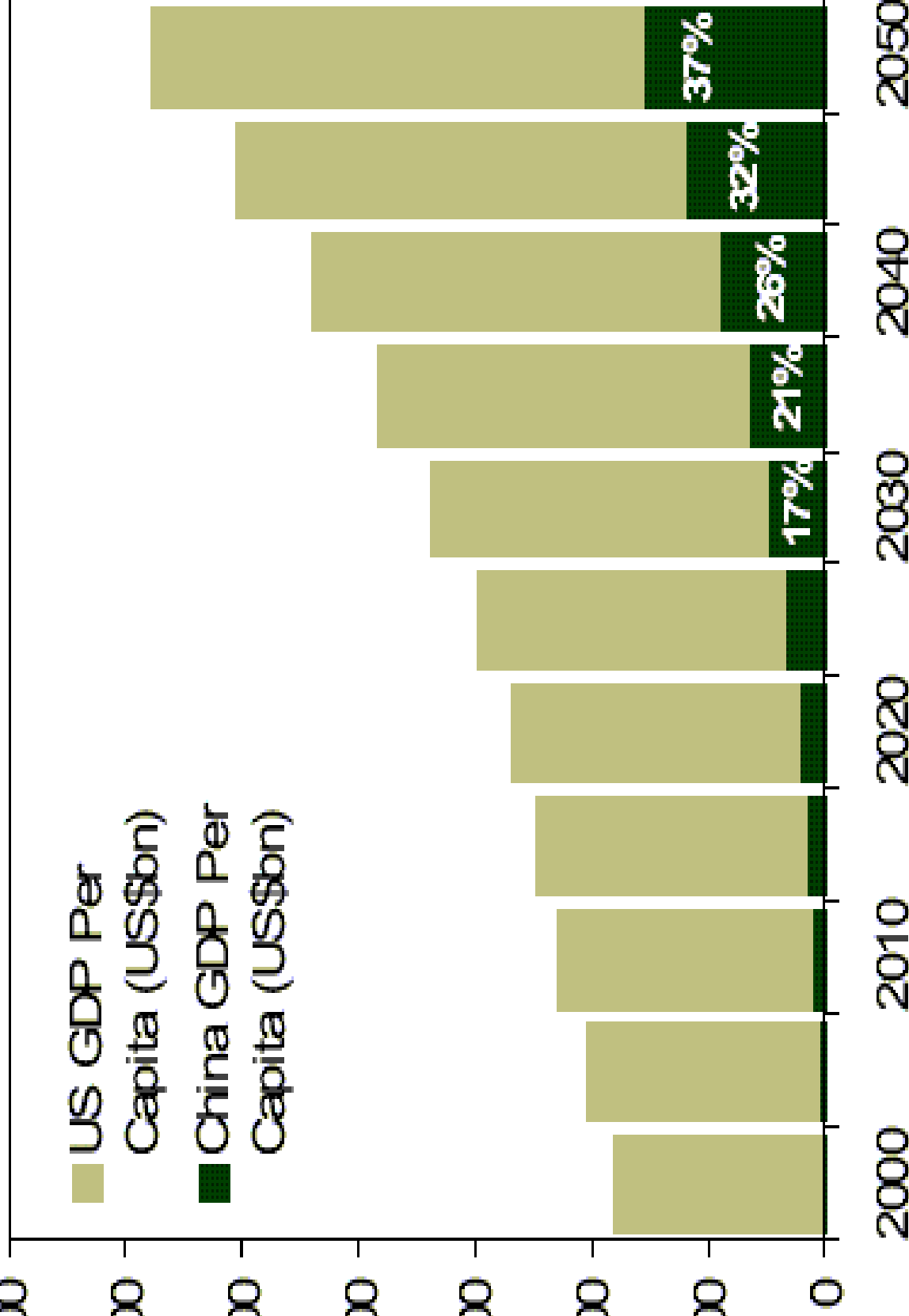
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■ US GDP Per

Capita (US\$bn)

■ China GDP Per

Capita (US\$bn)



2000

2010

2020

2030

2040

2050

Explaining success of China

- Macro economic characteristics (high S and I).
Domestic spending will rise
- Opening up the economy, including WTO membership,
inflow of FDI
- Location factors
 - Wages (price of labor relative to price of capital)
 - High educated younger generation and investments in R&D
 - Market/ market potential
- Labor shift and because of that increase in productivity
- Entrepreneurial spirit..... Will come
.....and copying!

Economic growth

.....Is sustainable

- Labour shifts from agriculture to industry and services
- Labour productivity in industry is seven times larger than in agriculture
- Shift will continue:
 - Agricultural laborers per acre in China is extremely high
 - Barriers for shifting labour will drop

Macro- economic risks

- Instability of the financial sector
- SOE
- Income distribution
- Overheated economy
- Renminbi
- Need to change economic growth through “transpiration” to growth by “inspiration”
- Relationship with US, Japan and EU

Banking sector

- State - owned banks (4 very large banks)
 - Allocating credit to SOEs based on government plans
- Nonperforming loans and insider lending
 - NPL/GDP: 22% in 2004.....??
 - NPL/total loans: 30%.....??
 - Finding solutions for bad debt problem

“Buying time to solve the triangle problem”

China Trade Deficit Factors

- Under-valuation (15-40%) of China's currency
- Unfair Chinese competition
 - Denial of worker rights
 - Failure to implement WTO obligations
 - Creation of new trade barriers
 - Subsidized credit – hundreds of billions of dollars of non-performing loans
- Domestic consumption spending boom in the US

Renminbi (yuan)

2.1 percent appreciation of the renminbi against the dollar China announced in July 2005

- a move to a managed float with reference to a basket of currencies
- Small daily fluctuations possible (+/- 0.3%)

The Chinese impact

Productie naar China	9,5%
Productie naar nieuwe toetreders EU	5,0%
Productie naar andere landen	9,2%
Productie in Nederland	76,3%

TABEL 6.1: Verplaatsen productie naar buitenland, percentage van aantal ondernemers

Trends in export 2005:

Production shift to China: 22%



"The China Price"

Pressure on prices
and wages



The Chinese impact?...CPB (August 25, 2006)

- Imports of cheap Chinese products have lowered Dutch inflation and stimulate consumption
- New expanding market
- China's growth strengthened the role of the Netherlands as key European distribution centre
- Lower global interest rates due to strong Chinese demand for foreign government bonds

The Chinese impact?...CPB (August 25, 2006)

- No negative economic impact due to the fact that Chinese export products are more supplements than substitutes of Dutch export products

Net result:

20.000 additional jobs

300 euro extra purchasing power

Therefore: “The increasing influence of China on the world economy does not require a major reorientation of Dutch economic policy”

Critique on CPB report

- Trade model is using figures until 2000
- In general, based on comparative advantage theory, there is no change in export flows and production/export structures of a country in the short-term

But:

Due to the enormous inflow of FDI, “Chinese” export may change considerably in the short term

Development of Chinese export structure; 1998-2005

Export product	Percentage change
Clothes/garment	12.8
Shoes	-6.2
Toys	-7.5
Plastic products	0.7
Furniture	45.1
Communication hardware	59.5
Machines	43.6
Electronice products	47.3
Automotive components	79.8

Chindia: “exports changed significantly over the past decade”

Innovative behaviour



Chinese outflow of Foreign Direct Investments

- China accounted for only 0.25% of global outward direct investments (ranking 30th)
 - Government stimulates outward FDI
 - Many companies are ready of “going global”

Determining Chinese industries and companies with globalisation potential

Filters

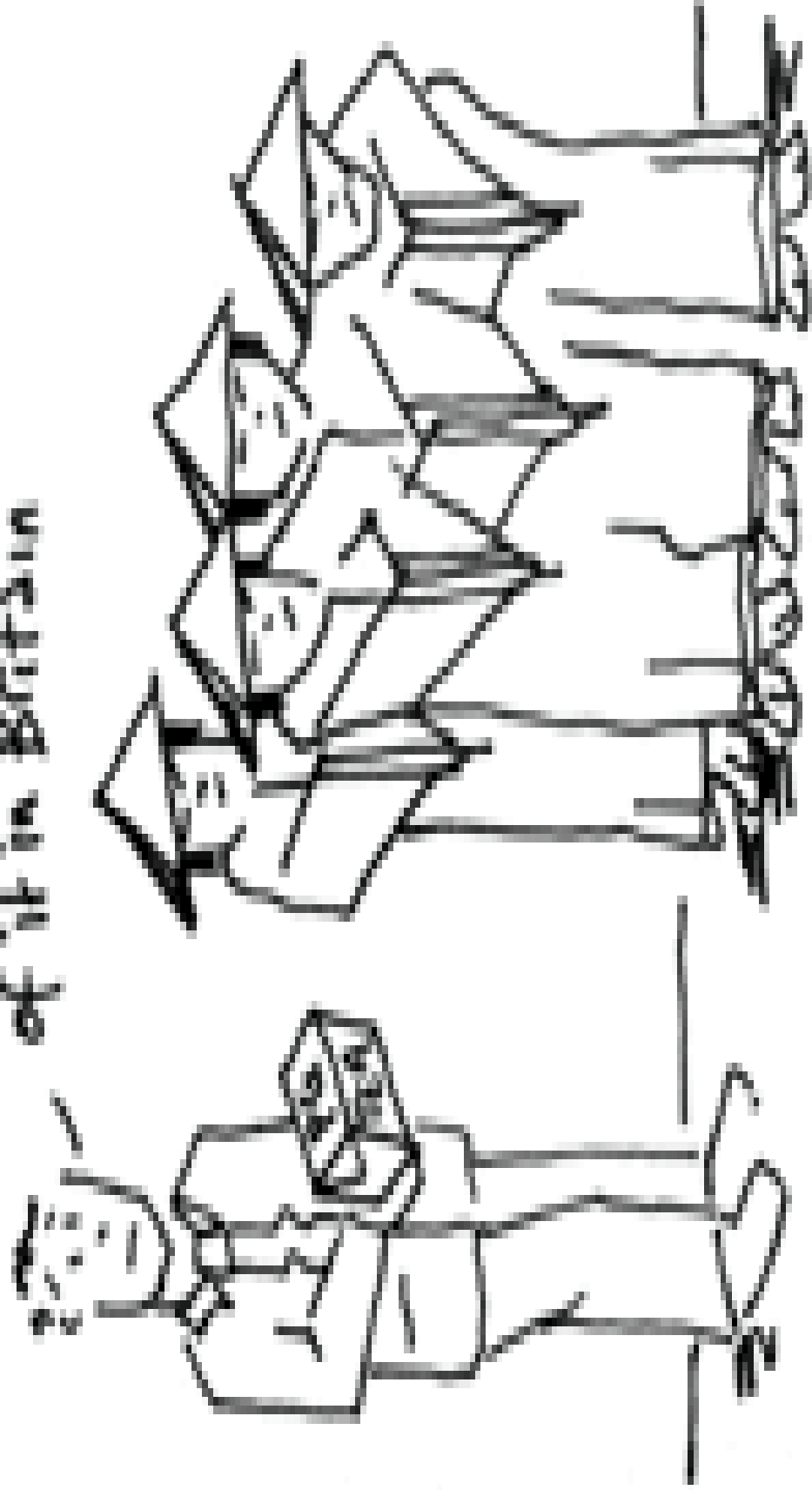
- Annual revenues over US\$ 500 million
 - Industry size as percentage of GDP
 - Degree of industry concentration
 - Export intensity
 - Government support (“go-out” policy)
 - Leading market position
 - Relatively large revenues from foreign activities

*1500 Chinese companies with global potential
(.....fierce dragons or cute pandas?)*

Business Failures

- Navigating the political and legal environment
 - China is not highly centralized (bureaucratic)...an extremely decentralised power structure: provincial and municipal governments
- Joint venture construction
- Chinese problems require Chinese solutions
- Chinese brands over global brands
 - Local tastes, preferences and pricing

It's called 'tea'
we drink a lot
of it in Britain



JT



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Business Failures

Difficulty	Expected <i>1 = not expected</i> <i>5 = expected</i>	Experienced <i>1 = not experienced</i> <i>5 = experienced</i>
Differences in culture	1 2 3 4 5	1 2 3 4 5
Language barrier	1 2 3 4 5	1 2 3 4 5
Tough competition from local competitors	1 2 3 4 5	1 2 3 4 5
Not understanding the local customer	1 2 3 4 5	1 2 3 4 5

Business Failures

Difficulty	Expected <i>1 = not expected</i> <i>5 = expected</i>	Experienced <i>1 = not experienced</i> <i>5 = experienced</i>
Bad quality of the human capital in China	1 2 3 4 5	1 2 3 4 5
Bad physical infrastructure	1 2 3 4 5	1 2 3 4 5
A lot of corruption	1 2 3 4 5	1 2 3 4 5
Unclear law-system	1 2 3 4 5	1 2 3 4 5

Business Failures

Difficulty	Expected <i>1 = not expected</i> <i>5 = expected</i>	Experienced <i>1 = not experienced</i> <i>5 = experienced</i>
A lot of bureaucracy	1 2 3 4 5	1 2 3 4 5
Other, namely...	1 2 3 4 5	1 2 3 4 5

Conclusion

- Chinese economic progress will continue
 - LT drivers are sustainable (eg. productivity)
 - ST drivers change towards domestic spending
- Macro economic risks are seen and there are solutions
- Speed of change: much faster than we may expect