

# China's Competitiveness in the Global Market

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## Abstract

China's exceptional economic growth has surprised everybody. The fact that it last this long is the thing that surprise people. Many well-developed countries like U.S., England, etc started to get worried weather China will become their biggest competitor. Every economic analyst has different view of this growth, about what is actually happening, how long will it last and will it collapse. They cannot predict too much because they could not get the entire information about what actually happen in China. The Chinese government only gives out the information that will not endanger their economy.

Chinese government has some big obstacles and challenges that can limit the economic growth. This research will discuss those obstacles and challenges. There are some flaws in using GDP as an economic development indicator and it should be discussed in this paper. China's global and local debts have passed the global warning limit, and it worries a lot of investors. Although there are some obstacles, China also got some key success factors. If they are used correctly, they might be able to strength China's economic growth and eliminate some of those obstacles and challenges. After looking at the obstacles and challenges, this research will try to provide some strategies that might be able to help the Chinese government in overcoming those obstacles and challenges.

This research will contribute some strategies to strengthen China's economy so it will be able to compete in the global economy. A growing country like China needs to be able to use its key success factors smartly in the global economy. The strategies that this research proposed use those key success factors to eliminate or at least minimize the obstacles that exist in China.

## Introduction

For centuries China stood as a leading civilization, outpacing the rest of the world in the arts and sciences, but in the 19<sup>th</sup> and early 20<sup>th</sup> centuries, the country was beset by civil unrest, major famines, military defeats, and foreign occupation. After World War II, the Communists under Mao Zedong established an autocratic socialist system that, while ensuring China's sovereignty, imposed strict controls over everyday life and cost the lives of tens of millions of people.

The People's Republic of China (China) is the world's most populous country and the second largest energy consumer (after the US). China has received much attention in the last decade as its economy has performed exceptionally well by most standards. After a soft landing from an episode of overheating in the mid-1990s, the Chinese economy managed to weather the Asian crisis of the late 1990s largely unscathed and has been able to sustain rapid growth in the face of the recent global downturn. Growth in China held up relatively well in the face of the global downturn in 2001. Although the external slowdown dampened activity, the impact was muted by continued robust domestic demand growth and rising foreign direct investment.

At the same time, however, many analysts point to some serious structural weaknesses in China's economy, such as problems in the state-owned enterprises (SOEs) and banks, growing unemployment and income disparities, weak governance and corruption, medium-term fiscal pressures, and environmental degradation. There are some concerns that these challenges, if unmet, could undermine sustained rapid growth and stability. The major task for the Chinese government today is how to sustain the economy's growth and development while spreading the benefits more widely across society.

China's economic development has proceeded unevenly, with urban coastal areas, particularly in the southeast, experiencing more rapid economic development than in other areas of the country.

### **Current Economic Environment in China**

In late 1978 the Chinese government began shifting from a sluggish, inefficient, Soviet-style centrally planned economy to a more market-oriented system. Although the political framework is still using strict Communist control system, the economic influence of non-state organizations and individual citizens has been steadily increasing. Now China has a mixed economy, with a combination of state-owned and private firms. A number of state-owned firms have undergone partial or full privatization in recent years.

The Chinese government has encouraged foreign investment offering several "special economic zones" in which foreign investors receive preferable tax, tariff, and investment treatment. The result has been a quadrupling of GDP since 1978. GDP growth has averaged over 9 percent a year, raising real income per capita fivefold, and more than 200 million people have been lifted out of poverty. (China: Competing in the Global Economy, 2003, p. 2). Measured on purchasing power parity (PPP) basis, China in 2004 stood as the second-largest economy in the world after the US, although in the per capita terms the country is still poor. (The World Factbook-China, 2005)

Breaking with previous policy, China in July 2005 delinked its currency from the US dollar, resulting in a devaluation of 2.1 percent. The Chinese Yuan now will float within a very narrow band against a basket of currencies from the country's major trading partners.

In March 2003, a long-expected transition in China's political leadership took place. Hu Jintao assumed the country's presidency, as well as chairmanship of the ruling Communist Party. Wen Jiabao became the new premier. In March 2005, Hu Jintao replaced former president Jiang Zemin as chairman of the Central Military Commission, completing the leadership transition.

China's entry to World Trade Organization (WTO) in November 2001 marks a watershed for reform. A new progress is needed to complete the unfinished reform agenda. WTO accession promises to stimulate this progress by increasing FDI, removing protection from inefficient industries, and spurring the development of the legal and regulatory framework necessary for a market economy. The Chinese government is aware that the benefits from WTO accession depend on the successful implementation of reforms to deal with the resulting increase of competition. It made a series of specific commitments to trade and investment liberalization which, if fully implemented, will substantially open the Chinese economy to foreign firms. In the energy sector, this will mean the lifting or sharp reduction of tariffs associated with imports of some classes of capital goods, and the eventual opening to foreign competition of some areas such as retail sales of petroleum products.

In 1978, the savings deposits of Chinese residents were 20.6 billion yuan (US\$2.49 billion), while now the figure has grown into over 7,800 billion yuan (US\$943.488 billion). This huge increase of citizen's saving deposits and state foreign exchange reserve, as well as the progress in infrastructure construction, has sufficiently proved the economic development of China.

China's energy consumption grew slowly and in recent years it even dropped. Some analysts thought that this is inconsistent with China's constant economic growth. Actually, this situation, where slower energy consumption growth than simultaneous economic growth, has extensively existed in the economic development histories of countries all over the world. Countries with economical powers, like US, Japan, and Germany have experienced occasionally similar situations to what is happening in China now. The actual reason behind this phenomenon is the change in technologies and industrial structure can always alter the relationship between energy consumption and economic growth in a nation's economic development process. During the past ten years, China's energy consumption cost for GDP growth has dropped annually by 5%. This shows that economy can be boosted by saving energy.

### **Major Obstacles and Challenges Faced by China**

China emphasis on a single statistic, the GDP, without taking accounts the costs to GDP, let alone other factors. The article "Does the Future Belong to China?" the author predicts that China's GDP is projected to overtake that of other major nations in the next 10 to 35 years. It stated that China's current GDP is US\$1.6 trillion, which may triple in the next 15 years, and it may suppress Japan and US in terms of total GDP by 2015 and 2039, respectively.

There are many flaws in using GDP as an economic development indicator, including:

1. The GDP does not measure social costs. The GDP is the total market value of all final goods and services produced by nation in a given year, of which the measurement is based on the value system of the economy in a particular country. For a country with a sound market mechanism, this measurement can accurately reflect the total market value of the economic activity as a whole. For a country evolving from a planned market economy to a free market like China, the GDP is unrealistic for measuring the total market value of all economic activities. For instance, China's GDP does not reflect factors pertaining to environmental pollution, worker's compensation insurance, child employment, medical insurance, social welfare, health problems, etc.

2. The GDP does not measure quality. Quality is not taken into account for purposes GDP, as GDP is calculated at the present market value of social activities. The wealth of a society accumulated by quality rather than quantity. It is of no use to accumulate greater quality. This involves issues at two levels. One is that only products of good quality have external exchange value. One of the most evident examples is that state enterprises in China are eager to get loan from banks in order to manufacture the identical goods with high demand in the marketplace. They even engage in manufacturing counterfeit articles. This soon results in over-production and surplus, and the market is rife with a commodity that has different grades of quality.
3. The GDP does not measure the effectiveness of resource allocation. From an economy perspective, expenditure itself is not a social cost. When evaluating the social cost of investment. For example: if the government makes military expenditure, such expenditures themselves are not social costs as they promote the development the military industry. However, if the investment in the military industry causes a shortage in the education budget or a failure to fulfill social needs, this is then a social cost of military development that needs to taken into account.
4. The GDP does not measure waste. There is no difference between wasting money and building school in calculate GDP. How much has China wasted each year? On one hand, it makes huge investments building the largest fiber optic telecommunication network in the world; and on the other hand, it placed restrictions on internet usage, with strict controls over Internet cafes and websites. Such waste is not reflected in the GDP.
5. The GDP does not measure negative impacts. The objective of all economic development is to have a positive effect. But Beijing government has long made policies according to the “will of leaders”. As a result, they push ahead with many projects to expand the nominal GDP. These are “leaders’ projects,” “image projects” and “accomplishment projects,” but in reality their economic effect is negative.

Presently, China is counting on massive investments of capital, labor and other resources to increase its GDP figures. It is a low-level production approach, which has low efficiency and high energy consumption. Though ostensibly China’s annual GDP growth rate is as high as 8 to 9%, its net profit is not high, and its social wealth accumulation is very low as well.

In 2003, China adopted a completely new GDP calculation method based on the 1993 SNA (System of National Accounts) standards jointly formulated by the United Nations, the World Bank, the International Monetary Fund, the Organization for Economic Co-operation and Development and the European Union. The new method supplants some contents of the guideline for measuring GDP and National Income initiated by the State council in 1992, including calculations concerning national income, fiscal credit balance, collective consumption and social consumption.

According to experts, the new method lays a solid foundation for the solution of two of major economic statistical problems in China. One concern the overestimation of the output value of the industrial and agricultural sectors and the other involves the serious underestimation of the thriving service sector. The overestimation of the output value of the industrial and agricultural output is the result of some local governments exaggerating “achievements” in the name of political career development but the national GDP figures will not change much as they strike a balance between the overvaluation with the underestimation of the service sector.

China has become the world’s factory because of all the foreign direct investment that came to the country. This has cause a lot of problems like high energy consuming, highly polluting, low technology, labor- and resources-intensive and low efficiency industries moved to China from all over the world. Most Chinese workers have not been able to improve the technical skills and wage levels, and will be forced to retire without any social security as early as 45 to years old. In the meantime, China’s industrial technology has remained at a low level for a long time now. About 200 million farmers have left their lands and have become cheap laborers. If those laborers lose their jobs and income, China’s society will be in chaos. One of the biggest reason why companies went to China to opened facilities there is because of the lax environmental regulations. Unlike U.S. where companies have to abide with lots of environmental regulations, in China they can use as many dangerous chemicals as they want. China has become a low-cost world manufacturer at the cost of cheap laborers and the destruction of its ecological environment.

The current debts Chinese banks carry for central and local governments have exceeded the global warning limit:

1. Central government debts

China’s current national debt is about 2 trillion Yuan (approximately US\$ 242 billion), which is about 20% of US\$ 11 trillion Yuan (US\$ 1.36 trillion) GDP for 2004. However, China also owes US\$ 170 billion (US\$ 21 billion) in overseas borrowing, which converts to more than 1 trillion Yuan (US\$ 123 billion).The total of the 2 debts is about 3.4 trillion Yuan (US\$ 419 billion).

In addition, China’s government has a deficit of about 300 billion Yuan (US\$ 37 billion), construction payable of 300 billion Yuan (US\$ 37 billion) and owes 240 billion Yuan (US\$ 30 billion) in export tax refunds. These are the 3.4 trillion Yuan (US\$ 419 billion) in debts add to 4.24 trillion Yuan (US\$ 523 billion), which is 38.8% of the GDP (this calculation is based on a GDP of 11 trillion Yuan).

China’s Premier Wen Jiabao once said that China’s state-owned banks’ bad debt rate is about 20%, an amount of around 3.4 trillion Yuan (US\$ 419 billion). Even if one-third of these bad debts could be collected, the loss is about 2 trillion Yuan (US\$ 247 billion). This totals China’s central government total debt close to 6 trillion Yuan (US\$ 741 trillion), or more than 50% of its GDP. Those numbers are from official resources (which is far above the global warning limit).

## 2. Local governments' debts

There are different sources of local government debts:

- a. Borrowing domestically or internationally through local banking systems, and the local governments' guarantee for borrowing by local state-owned enterprises,
- b. unpaid salaries of government employees and state-owned enterprise employees,
- c. unpaid social security benefits, and
- d. all kinds of construction payables.

In China, more than 70% of the county governments and more than 90% of the township governments have high-level debts; the total debt of township and villages level governments is more than 600 billion Yuan (US\$ 74 billion).

600 billion Yuan (US\$ 74 billion) is only an average for different estimates of the total debt of township and village governments; the high-end estimate is as high as more than 1 trillion Yuan (US\$ 123 billion). That means the village governments' debt is close of 10% of China's GDP, and 30% to 50% of its total national fiscal income, which exceeds the long-term construction national debt.

Table 1: Statistics of China's National Debts from 1981 to 2005 Unit:  
Renminbi (yuan)

Year	Total Issuance (billion yuan)	Budget Deficit (billion yuan)	National Debt Balance (trillion Yuan)	Percentage of Debt on GDP (Debt Ratio)	Contribution to Economic Growth
1981-1997	Accumulated figure 905.78	-	-	-	-
1998	200	158.3	1.05	13.60%	1.50%
2001	150	259.8	-	16.30%	1.80%
2002	592.9	309.8	1.87	18.05%	Estimated between 1.5% to 2.0% after 2002
2003	640.4	335	2.1	20.00%	
2004	702.2	319.8	2	11.90%	
2005	692.34	300	2.2	16.80%	

(Understanding China's Economy Requires Looking Beneath the Surface, 2005)

The Chinese government has some major obstacles that might cause the collapse in its economy. The obstacles can be categorized into two types: macro-economic problems and socio-economic problems. Moreover, there are two more problems above these problems: one is that government official statistics is not reliable; the second one is that after the "reform and open" policy over the past 25 years the Chinese Communist Party (CCP) has not changed as a political system. The CCP has not changed its nature in the slightest way at all.

## Macro-economic Problems

For macro-economic problems, there are some issues of government budget, national income account, banking and financial market, and state enterprises. The macro-economic problems consist of:

1. Budget deficits: official deficits are not particularly big. But there is much “under the table” activity National income account: the figures are made up and contradict each other on the website of National Statistical Bureau.
2. Banking and financial market: the bad loans are so large that the state banks should have already been so bankrupt several times over. As for the stock market it has already collapsed (to record low levels).
3. State enterprises: the growth of state enterprises in China embodies the collapse of the economy. For example:
  - a. Budget holes: there is no pension system in rural areas. For urban areas, the old system of “pay-as-you-go” is changing to “fully funded.” However, because of the lack of revenue, the funds of “fully funded” that should be saved for future use have been used to pay current payments, and resulted in a lot of empty accounts. The amount of fund in 1997 is 14 billion, in 1998 is 45 billion, in 1999 is 100 billion, in 2000 is 200 billion, and in 2003 is 470 billion.
  - b. Economic collapse will be a result of the growth of state enterprises. Some analysts think that the Chinese economy is over-heated due to an extremely inefficient use of investment and corrupt practices. The communist government has too many wasted investments, no care for cost-benefit analysis, and no monitor and check-balance system.

## Socio-economic Problems

For socio-economic problems, there are issues of unemployment income and wealth distribution, farmers and agriculture, mass corruption, declining social morals, failing education, huge environment and ecology problems. Chinese society has stepped into an unstable period. These problems include:

1. the largest scale of economic structure adjustment in the world,
2. the largest scale of “lay-off flood” and “unemployment flood” in the world,
3. the most significant urban-rural inequality,
4. the fastest growth of income inequality in the world,
5. severe corruption and economic loss and
6. severe environmental problems.

## China's Key Success Factors

After talking about obstacles and challenges faced by Chinese government, now let's talk about some of the key success factors that they have. These key success factors can help China in maintaining its growth rate:

1. Chinese people have the highest saving rate; around 47% of their GDP has been saved (compared with just 14% for the U.S.).(China's Economic Growth, 2005) This kind of savings rate pattern is typical of low income countries. Poor, newly market-oriented countries usually try to save their way to wealth. Chinese authorities would like to see those savings to work to grow the Chinese economy, including through building domestic demand. Chinese consumerism is already starting to happen. It began, of course, with the goods they make so cheaply for the rest of the world-electronic products and appliances, for example. If you can get a DVD player for just \$29.99 in the U.S., imagine how little it costs in China, where it's made. Now around 59% of households in China own one. There are 209 telephone mainlines per thousand people in China, compared with just 2 in 1978 and 215 mobile phones and 75 cable TV subscribers today vs. zero in 1978. The vast majority of urban residents there now have washing machines, refrigerators and other household conveniences.
2. China was the world's second largest consumer of petroleum products in 2004, having surpassed Japan for the first time in 2003, with total demand of 6.5 million barrels per day (bbl/d). China's oil demand is projected by EIA to reach 14.2 million bbl/d by 2025, with net import of 10.9 million bbl/d. China's petroleum industry has undergone major changes over the last decade. In 1998, the Chinese government reorganized most state-owned oil and gas assets into 2 vertically integrated firms – the China National Petroleum Corporation (CNPC) and the China Petrochemical Corporation (Sinopec). Before the restructuring, CNPC had been engaged mainly in oil and gas exploration and production, while Sinopec had been engaged in refining and distribution. The restructuring created 2 regionally focused firms - CNPC in the north and west - and Sinopec in the south, though CNPC is still tilted toward crude oil production and Sinopec toward refining.

The intention of the restructuring was to make these state firms more like vertically integrated corporate entities elsewhere. In connection with this process, the firms have been spinning off or eliminating many unprofitable ancillary activities such as running housing units, hospitals, and other services near company facilities. Massive layoffs also have been undertaken because they were severely overstaffed.



3. China is one of the most attractive foreign direct investment destinations in the world. Global executives are more likely to invest in China than at any time since 1998. FDI has become an important component of China's national economy, and an engine of growth. FDI, where it generates and expands businesses, can help stimulate employment, raise wages and replace declining market sectors. Infrastructure development and technology transfers via FDI are beneficial to China. Parent companies can support their foreign subsidiaries by ensuring that adequate human resources and infrastructures are in place. In particular "Greenfield" investments into new business sectors can stimulate new infrastructural development and technologies to host economies. These developments can also result in social and environmental benefits, but only where they "spill over" into host communities and businesses. Investment in research and development (R&D) from parent companies can stimulate innovation in production and processing techniques in the host country. FDI can have important social benefits and can lead to poverty alleviation if employment is generated for unskilled labor or if capacity-building and training is built into the activity, upgrading human capital. A 2000 International Labor Organization (ILO) study found that large-scale foreign-owned enterprises in China paid considerable attention to training and skill development.

### **Suggested Strategies for Global Competition**

There are some strategies that I think China needs to do to be able to compete in global market:

1. China should build its infrastructure further.  
China only has one-fourth the road systems of the U.S., and it has taken time a quarter century to double it (from 533,144 miles in 1978 to 1,124,555 in 2003). They have a fraction of the pipelines, dams, satellites, internet servers, fiber-optic cable and other infrastructure assets that we do and a fraction of what they need to support a big economy. Pollution is a big and growing problem. Institutions have to be designed, and laws debated and written to support commerce. All these things take time. Everything can't be built as fast as a textile plant. Especially not the key ingredient for economic prosperity in an interdependent world: an educated, knowledgeable population.
2. China should make huge investment in education for R&D.  
Developing basic infrastructure is important, but developing education is crucial if China is to stay on the capital road. Manufacturing is a means to an end. It's not the top rung on the income ladder. No economy can reach the pinnacle of wealth without its labor force becoming highly educated, and highly educated people tend to work in services. Doctors, lawyers, dentists, accountants, engineers, scientists, professors, computer programmers, systems architects, consultants, financial advisors, pharmacists, actuaries – these are all service-sector jobs, and high-paying ones at that. They all have one thing in common – education. To keep climbing the income ladder, China will have to make a huge investment in education. Presently, just 18 % of China's population aged 25-65 has a high school degree, compared with 84 % in the U.S. Just 1 out of 20 Chinese in that age group has a college degree, compared with almost 1 in 3 in the U.S. China has just 86 university students per 10,000 of the population. The U.S. has 562 –seven times as many.

To be sure, China imports education from the rest of the world. In 1978, only about 1,000 Chinese students were studying abroad. At last count in 2002, 182,000 were. (China's Economic Growth, 2005)

3. China should strengthen the enforcement of its laws and regulations and make new regulations that will protect China's environment.

China actually has laws and regulations on piracy and counterfeit but the government does not enforce it because one of their biggest income producers came from pirated and counterfeited products. What they do not realize is that this situation eliminates the country's ability to absorb foreign direct investment from companies that are afraid that their products might be pirated or counterfeited. These companies are also afraid that their technology might be stolen, especially software companies.

China should also start protecting its environment by making better law and regulation on chemical usage. The Chinese government should realize the danger of using some of those chemical to the environment and also to the people. The new regulation should If China is not willing to eliminate protectionism, it should reduce red tape and regulation, encourage free markets for capital as well as goods and services, live by the rule of law, punish corruption and corporate malfeasance, if China is not willing to let old jobs go by the wayside and otherwise unleash the competitive forces that make an economy nimble, It would not keep pace with the leaders. Leaders, like U.S., do these things. This is how they become leaders. This is how the U.S. got to where it is today, becoming the mightiest economic machine in history.

China has improved somewhat in a few of these dimensions, but it is still far behind in every single one. For example, China ranks 31<sup>st</sup> in the International Institute for Management Development's 2005 competitiveness score. It ranks 112<sup>th</sup> in the Heritage Foundation's economic freedom score. It ranks 71<sup>st</sup> on Transparency International's 2004 corruption score. These indicate that China got a long way to go before it creates conditions of truly sustainable economic growth in today's world.

4. The Chinese government should stabilize the political environment if they want to absorb more foreign direct investment. Political stability is one of the most important aspects in choosing which country to invest in.

The Chinese Communist Party (CCP) is well known to be one of the most violent, and corrupt government in history. The corrupt nature of the CCP will make all good things turn bad. For example, the Australian government has been one of the most respected countries in observing human rights. But it is only caring about money when it's dealing with China. France and Germany are also the same. Many multinational companies are also guilty. For example, Yahoo! agreed with the Communist regime to delete all information with key words that it does not like, such as human rights, democracy, and Fulan Gong.

5. The Chinese government should invest more in supporting local companies, so they can compete in the global market.

China should not just be the world's factory, it should grow its own companies. However, these companies should not be state-owned because it will restrain the companies' ability to grow. These companies should be able to compete with other multinational companies

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