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Current Review:

Pessimism Erupted in Washington Days Before Obama Meets Hu in London

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Hearings in Washington today focused on China's support of its "pillar industries" and painted a somewhat gloomy picture. A constant criticism from numerous experts in many professions emphasized China's heavy user of subsidies and tax benefits as incentives to U.S. manufacturers in order to relocate plants to China. Another hearing is scheduled for April 30th dealing with China's Impacts on U.S. National Security. These hearings are an outgrowth of Congress's establishing a mechanism to stay abreast of the national security implications of bilateral trade between the United States and China.

Professor George Haley of the University of New Haven was more analytical than partisan and raised the following questions: "What impact has China's support of its pillar industries had on U.S. industries and the U. S. Economy? How are China's industrial policies likely to affect global markets and American competitiveness? Will U.S. companies be able to compete with Chinese state-owned companies that are able to tap government resources? "

In answering his first question about the impact on U.S. industries, Professor Haley discussed the steel industries in the U.S. and China. Chinese steel exports to the U.S. in 2008 were twenty times greater than just five years earlier. While most people think that this development can be explained by differences in relative labor costs in the two countries, Professor Haley argued differently because as he said labor is approximately ten percent of the total cost to produce steel. He acknowledged though that Chinese labor costs per hour in the steel industry are roughly one twentieth that of U.S. labor.

Professor Haley's statistics showed that from 2003 to 2007, the U.S. steel industry lost 10,660 employees and 9.9 percent of its workforces. Due to its economic job multiplier effect, the total job loss amount to 35,178 jobs. Over twenty U.S. steel companies have gone out of business.

Only a few weeks ago, U.S. steelmakers protested vigorously against foreign steel imports and asked for tariffs. David Hartquist, a partner at the Washington-based Kellye Drye law firm believes the Chinese are dumping their steel products due to government subsidies. He is rated by The Lawdragon 500 as one of the top ten international trade lawyers in American. He was once general counsel of the White House Council on International Economic Policy under President Ford. The U.S. steel industry sought a "Buy America" clause from Congress.

Whereas Professor Haley believes many industries will be able to compete globally, their market shares, costs, profitability and employment levels will be affects. He questions the long-term viability of some second-tier companies.

Regarding the question of China affect global markets, Professor Haley foresees long term but not immediately severe price competition and thin margins in many industries. “I do believe that in the longer term, the Chinese government’s brand-building efforts will pose a significant threat to American interest in particular, due to the position of our products in world markets,” said Professor Haley. “Though not true in all product markets, generally, customers see American brands as more mass-market than European and Japanese brands. This market position makes U.S. products more vulnerable to Chinese brand building than their European and Japanese counterpart,” he said.

Regarding the question whether U.S. companies can compete with Chinese state-owned companies, Professor Haley said U.S. companies will not be able to compete on price. Their only hope is “constant product and process innovations just to survive.” He ends with a somewhat pessimistic view: “With much of their (Chinese) R & D expenses paid for by the government, a major element in the cost of new products and technologies is being minimized for Chinese companies.” He cited the recent Coca-Cola application to acquire Huiyuan with a 42 percent share of the domestic market for fruit juices as an example of “the important of brand equity for China: China’s Ministry of Commerce did not want Coca-Cola to acquire the brand rights of Huiyuan and expressed concerns about the loss of a lending brand,” he said.

The bottom line to Professor Haley is that “direct subsidies to Chinese industries hinder U.S. companies’ abilities to compete in mass markets where low price constitutes the primary strategy.”

Ralph E. Gomory, Research Professor at New York University Stern School of Business and President Emeritus of the Alfred Sloan Foundation, had a distinct negative view.

Different from Japan’s model of the 1970’s and 1980’s, China has chosen a distinct path of development which is based on subsidizing companies. Its incentive to foreign manufacturers makes their operations profitable. “The result is that U.S. companies are contributing to the development of China and simultaneously contributing to the loss of jobs and destruction of industries in the United States. But in creating their profits this way, they are building up the GDP of other countries while breaking their once-tight links with America’s own GDP. I would like to point out, however, that the view that the industrial development in your trading partner can be harmful to your total GDP is not new. We are losing high-wage and high tech jobs today: This conforms to the notion that we have reached the point of conflict between corporate and country goals,” he lamented.

These hearings reflect the dilemma President Obama has on his plate. He and Secretary Geithner have felt the magnitude of a dramatic populist backlash from the bonus saga at AIG. President Obama travels to London next week to attend the meeting of the Group of 20 industrial and developing countries, including China. Will he have the populist backlash in his mind set when negotiating with the Chinese or will he able to roll with the punches from today’s hearing in Washington and meet the needs of the Chinese to protect its trillions in dollar assets? His all-network television offensive after today’s hearing showed his mind set before meeting President Hu Jintao in London next week.

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