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# An Economic '800-Pound Gorilla': China is consuming and selling in huge quantities. It is moving markets, cowing the competition and inspiring a rush of foreign suitors

by Evelyn Iritani

China sent shock waves through the metals markets in June 1992, when it began buying huge amounts of copper, pushing the price from 98 cents to $1.20 a pound. By the end of the summer, Chinese speculators had reportedly made $300 million to $400 million in profits and Western traders were suffering, having bet that prices would fall sharply due to new mines coming on line.

A tiny pink worm and a bout of bad weather forced China into the cotton market in a big way in the spring of 1995, sending world prices to their highest level since the Civil War. In California's Imperial Valley, cotton farmers, who export 80% of their crop, celebrated a record year.

People scoffed when Mastercard International went to China in 1988 to cultivate its next generation of plastic-users. But in a country as big as China, even a fraction of the market is huge. Now China is Mastercard's second-biggest and fastest-growing market. Last year, its 11.4 million Chinese cardholders racked up $53.6 billion in purchases.

Wake up, world. From cotton to copper to credit cards, the Chinese are consuming and selling in such huge quantities that they are moving markets, cowing the competition and inspiring a rush of foreign suitors. In numerous arenas, China has already emerged as the world's No. 1 player.

"When McDonald's starts selling a [pork 'hamburger'], the markets go wild," said Rich Brecher, vice president of the U.S.-China Business Council in Washington. "Whenever China even starts thinking about bacon, the same thing happens."

Sometime early in the next century, the Asian giant is expected to become the world's largest economy, eclipsing Japan and the United States. To get there, the Chinese government plans to spend as much as $250 billion--the equivalent of the combined gross domestic products of the Philippines, Singapore and Thailand--developing power plants, roads and airports, telecommunications systems and a manufacturing base to satisfy its 1.2 billion people.

That kind of spending has a tumultuous effect on the global economy, as builders, architects, steelmakers and telephone companies shift strategies, build new factories and cozy up to officials responsible for dispersing this infrastructure bonanza.

Last week's news that in June China registered the largest trade surplus with the United States, bypassing Japan, was one more reminder of the challenges posed by this awakening Communist giant as it unleashes the productive capability of 20% of the world's population.

## The Giant Is Awake

China's economic ascendancy is already affecting financial markets, trading patterns and worldwide wages and living standards. But given the dramatic changes engineered by the nation's aging leaders over the last decade, it is difficult to predict all the ramifications of its move to the top of the economic heap.

Spurred by the rise in bilateral trade conflicts, a growing number of U.S. policymakers and business people support China's bid to join the Geneva-based World Trade Organization, where it would be subject to the rules of the international trading system. But that effort has bogged down in a debate over the conditions of China's admittance.

"China's ability to disrupt the international economic system is something we're becoming increasingly aware of," explained Brecher, of the U.S.-China Business Council. "That is why it is very much in our national interest to bring China into the WTO."

While China remains a relatively poor country, with a per capita income of $500, economists estimate that as many as 200 million middle-class consumers already have money to burn on Procter & Gamble shampoo, Budweiser beer and imported children's clothing.

And China's nouveaux riches, believed to include at least 1 million millionaires, are buying up gold jewelry, exotic seafood, imported liquor and luxury cars.

<u>Land of Opportunity</u>

Market opportunities abound. Consider:

! China has moved into second place behind the United States in cellular telephones, with 5.5 million subscribers. U.S. telecommunication giants Motorola Inc. and McCaw International have signed partnerships with the Chinese to provide cellular facilities or service, attracted by the combination of a huge population and one of the world's lowest rates of telephone ownership. China has just 2.3 telephones per 100 people, compared with 59.4 per 100 in the United States.

! The Chinese government's one-child policy of population control has created a new class of "little emperors," whose care and comfort have spawned a boom in children's toys, educational games and clothing. Already, about $5.9 billion a year is being spent on Chinese children, only slightly less than is spent on children in the United States, according to SRI Consulting in Menlo Park, Calif., a subsidiary of SRI International. In Beijing, nearly half of the average family's disposable income is spent on goods and services for children.

! Over the next decade, the Chinese government plans to add each year 15,000 megawatts--the equivalent of New England's total power capacity--to China's power base. Already, China has the world's fastest-growing electric power industry, having added over 20,000 megawatts of generating capacity in just two years.

Two decades after the U.S. and China normalized relations, marking the start of China's commercial opening to the non-Communist world, the threat is not the export of Maoism but the flood of low-cost, labor-intensive goods that overwhelm foreign competitors and shake up world markets. The first to feel it were the producers of textiles and apparel, followed by manufacturers of electronic goods, tools and small appliances.

China has become the proverbial double-edged sword for U.S. companies increasingly dependent on a trade relationship vulnerable to geopolitical tensions, natural disasters and shifting Chinese policies.

U.S. executives are scouring the Chinese countryside, trying to determine how to secure a slice of this potentially huge market while protecting their technological edge in a country known for piracy. "Chip companies such as Intel are scrambling now to find out how to get into the Chinese market without having to offer up a lot of technology for free," said Jeff Wier, a spokesman for the U.S. Semiconductor Industry Assn.

The flow of Chinese products into the world market is also accelerating, as modernization of state factories speeds up and more joint ventures are financed by the world's largest stream of foreign investment. In the first nine months of 1995, the export of electronic goods and machinery from China jumped 60% over the previous year.

"When they do trade, they release a tremendous productivity onto the world," explained J. Ray Bowen, a China specialist at the University of Missouri-St. Louis. "Once they decide to do it, they can make progress within a year or two that took decades for other developing countries to make."

"[The export of] fax machines jumped over thirtyfold in the first nine months of 1995," said Eilif Trondsen, research director at SRI Consulting.

And China's economic coming of age is not affecting only developed countries. As the Asian behemoth expands its capacity, the overflow is hitting less developed countries in Asia and Latin America, threatening their efforts to trade their way out of poverty. Several years back, the Mexican government imposed steep tariffs on Chinese textile and apparel imports after its domestic producers complained that they were being threatened with extinction.

Silk Road to Riches

To understand China's economic clout, one has to look no farther than the clothes rack at Target, Wal-Mart or Kmart, where silk, once considered the fabric of royalty, is now the uniform of the middle class.

After the Chinese government launched its economic reforms in the late 1970s, a group of U.S. and Hong Kong business people worked with Chinese manufacturers to develop cheaper silk. Within a decade, the Chinese had a high-quality, washable silk that became a low-cost substitute for polyester and other synthetic fabrics.

In the last five years, the value of silk imports into the United States, nearly all from China, has more than doubled to $1.1 billion.

"The Chinese do have a monopoly on the best, most affordable, highest-quality silk available," said Elizabeth Terrell, a partner in Lizden Industries Inc., a silk apparel company in New York.

The Clinton administration discovered just how important China is to U.S. importers and retailers when it threatened to impose $2 billion in sanctions against Chinese products, including silk, in a dispute last year over widespread Chinese piracy of software, music and videos. A parade of small silk importers and major retailers such as Liz Claiborne testified that their business would be devastated if the sanctions went through. An eleventh-hour agreement averted a trade war.

China has never shied away from using purchases as leverage in dealings with other countries, a strategy that will become increasingly effective as its buying power expands. When relations with the U.S. soured last year due to tensions over trade and relations with Taiwan, the Chinese warned that Boeing Co., which was bidding on several multibillion-dollar Chinese airplane contracts, would feel its wrath.

In April, the Chinese seized the opportunity to register their anger with the United States by ordering $1.5 billion worth of airplanes from the European consortium Airbus Industrie, Boeing's chief competitor.

A shift in China's domestic politics can also move world markets, since Beijing's aging leaders still exert tremendous control over the massive economy through five-year plans, government decrees and fiscal tinkering.

The China card is played in a number of commodities markets, including wheat, rice, vegetable oils, nonferrous metals and certain chemicals, such as fertilizers. China, the world's largest supplier of tungsten and antimony, metals used in weapons production, closed a number of mines when demand fell after the end of the Cold War. But when there was an unexpected surge in demand for those metals in the first nine months of 1994, the prices nearly tripled and China reaped a handsome profit.

Sometimes, it is natural disasters that force China to go on a shopping binge. When the Chinese--suffering from a spell of bad weather and an infestation of bollworms--purchased 300,000 bales of cotton in April 1995, the price of cotton rose five cents a pound in a matter of days. By the end of May, cotton was selling for $1.17 per pound, the highest price since the Civil War.

"When China enters the market, it is the 800-pound gorilla," said Mark Bagby, director of communications for Calcot Ltd., the Bakersfield cotton cooperative.

This June, a U.S. official predicted that the devastating floods in China earlier this year, along with continuing pest problems, would force the Chinese into the market again as buyers. Cotton prices edged up, in spite of China's insistence that its cotton harvest is right on target.

Disgraced copper trader Yasuo Hamanaka has enjoyed the profits, and felt the pain, of the China connection. During his highflying career at the giant Sumitomo Corp., where he gained the nickname "Mr. Copper" for his aggressive copper trades, he frequently profited from price shifts attributed to large Chinese sales or purchases.

China, whose massive building program has created a huge appetite for copper, steel and other construction materials, evolved into a significant player in the copper market in 1992 and 1993, becoming a major buyer and drawing down the world's limited reserves.

But last spring, when the market began turning against Hamanaka, the Chinese joined others in unloading huge amounts of copper. In two days in May, the price fell 12%. By the time Hamanaka was fired the following month after prices continued falling, the giant Japanese trading firm had lost at least $1.8 billion.

With Hamanaka out of the picture, the Chinese are the biggest game in town and rumors are flying. Wiktor Bielski, senior commodities analyst and a director at Deutsche Morgan Grenfell, a London investment bank, expects the Chinese to come back into the copper market because it faces a projected 250,000-ton shortfall in 1996. If so, prices could shoot up as much as 10% in the next four to six weeks.

"Certainly, if the Chinese come in and looked to buy in size, it would be a market-moving event," Bielski said.

<u>The Changing Consumer</u>

A portrait of Chinese consumers, according to a Gallup Poll of 3,400 Chinese conducted in 1994:

92% watch television

64% watch televised sports

60% like going to movies

58% play cards regularly

95% have electricity at home

24% have cable television at home

9% have a telephone at home

1% have hot running water at home

84% own a television set

81% own a bicycle

63% own an electric fan

3% own a car

Source: Gallup Organization

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