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ECONOMIC VIEWPOINT

By Jeffrey E. Garten

When Everything Is Made in China

The world economy is getting more reliant on Chinese factories. But having one giant supplier could mean a giant disruption

During the past few months, Intel Corp. ([INTC](#)) announced a \$100 million investment in Shanghai to assemble Pentium 4 microprocessors. Dell Computer Corp. ([DELL](#)) moved its giant PC-making facility from Kuala Lumpur to Xiamen. The provincial government of Shenzhen said it would provide \$5 billion to boost its integrated-circuit industry. It's not hard to connect the dots. "China is becoming a manufacturing superpower," Kenneth Courtis, Goldman, Sachs & Co.'s vice-chairman for Asia, says, "and the momentum seems unstoppable."

The big question is whether the world economy is becoming so dependent on China as an industrial lifeline that it will soon be dangerously vulnerable to a major supply disruption caused by war, terrorism, social unrest, or a natural disaster. In other words, will China's importance to global manufacturing soon resemble Saudi Arabia's position in world oil markets?

Among developing nations, China has been the largest recipient of foreign investment, averaging about \$40 billion per year during the late 1990s. Membership in the World Trade Organization will result in even higher levels. U.S. companies are shifting manufacturing from Malaysia, Thailand, Indonesia, and even Mexico to China. Toshiba Corp. ([TOSBF](#)) is making its TVs on the mainland, and Sony Corp. ([SNE](#)) is manufacturing its PlayStations there. Taiwan's companies produce half of all their information-technology products in the country.

China's advantages are numerous. Its wage rates are a third of Mexico's and Hungary's, and 5% of those in the U.S. or Japan. China's investments in education and training are attracting research facilities from companies such as IBM ([IBM](#)), Motorola ([MOT](#)), and Microsoft ([MSFT](#)). The critical mass of factories, subcontractors, and specialized vendors has created a manufacturing environment with which few can compete. China is not just an export platform, either; its large and expanding domestic market is another attraction.

The mushrooming investment also reflects the obsession among global CEOs to lower production costs by outsourcing whatever they can to large-scale specialists. According to Bear, Sterns & Co., 50% of all manufacturing could be outsourced by 2010. Flextronics International Ltd. ([FLEX](#)), the world's largest manufacturing subcontractor, is illustrative. It operates in 28 countries on behalf of companies selling everything from cell phones to washing machines. Its revenues have grown from \$100 million in 1993 to an estimated \$14 billion today. Its business in China is projected to double this year over

2001 and could reach 40% of its worldwide production in two years, up from 24% in 1998.

How worried should the U.S. be? To be sure, in the 1980s, one heard false alarms about Japanese dominance of high-tech industries. But China is far more open to foreign investment, along with greater cost advantages and more rigorous higher education.

No one would say China dominates manufacturing--yet. But in April, Congress' General Accounting Office criticized the Clinton and Bush Administrations for failing to analyze China's growing sophistication in semiconductor technology. In the June issue of *Harper's*, investigative journalist Barry Lynn underscores the vulnerability of the U.S. economy to global supply lines that originate in China and Taiwan and are designed for just-in-time delivery to our critical industries. Michael Marks, chairman and CEO of Flextronics, has concerns, too. "I worry that CEOs are overreacting to short-term cost considerations," he told me. "Too much concentration in China could lead to serious supply disruptions. It would be better if their manufacturing facilities were more geographically dispersed."

Unfortunately, it is no one's job to analyze the aggregate risks. Chief executives are rightfully seeking profits in a hypercompetitive world. China is admirably opening its economy to foreign investment. The national-security community is understandably focused on terrorism and weapons of mass destruction. Threats to highly complex global supply chains seem not to be the subject of any national or international group.

There isn't an easy answer for every problem, of course. But it is not too much to ask the Bush Administration to create a joint government-business task force to examine key questions. Is the approximately 90% of all foreign investment that is geographically located in China's coastal provinces a dangerous concentration? Should Washington take another look at tax and tariff incentives to make the entire Caribbean Basin--Mexico, Central America, and the islands--more attractive to foreign manufacturers? Should multinational companies be encouraged to hold larger inventories closer to home? Does China need to beef up its security around its vast industrial parks?

For a quarter of a century, Washington and Wall Street have wanted China to become an integral part of the world economy. Their wish has been granted, and now it's time to come to grips with the implications.

Jeffrey E. Garten is dean of the Yale School of Management. A former investment banker, Garten is the author of *The Mind of the C.E.O.* (jeffrey.garten@yale.edu).