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THE “CHINA PRICE” AND WEAPONS OF MASS PRODUCTION

The China Price. They are the three scariest words in U.S. industry. Cut your price at least 30% or lose your customers. Nearly every manufacturer is vulnerable—from furniture to networking gear. The result: a massive shift in economic power is underway.

—*Business Week*¹

China has an official policy for the economy to grow at 7%–8% per year, the rate which the ruling mandarins calculate is needed to create about 15 million new jobs a year, to absorb new entrants into the labor market and discards from the shrinking state sector. Every policy, from the value of the Chinese currency to the delay in closing an unsafe coal mine, is calibrated to ensure that economic output continues to expand at this rapid pace.

—*Financial Mail*²

Since 1980, China's Adam Smith-on-steroids economy has grown by almost 10% a year—doubling an astonishing three times. During its ascent, China has far outperformed Japan's 1980s "economic miracle." It has also run circles around the vaunted "Four Dragons"—Hong Kong, Korea, Taiwan, and Singapore—even in their economic heydays.

Any complete understanding of the Coming China Wars must begin with this observation: China's hyper-rate of economic growth is export driven; and the ability of the Chinese to conquer one export market after another, often in blitzkrieg fashion, derives from their ability to set the so-called China Price.

The China Price refers to the fact that Chinese manufacturers can undercut significantly the prices offered by foreign competitors over a mind-bogglingly wide range of products and services. Today, as a result of the China Price, China produces more than 70% of the world's DVDs and toys; more than half of its bikes, cameras, shoes, and telephones; and more than a third of its air conditioners, color TVs, computer monitors, luggage, and microwave ovens. The country also has established dominant market positions in everything from furniture, refrigerators, and washing machines to jeans and underwear (yes, boxers *and* briefs).

Given China's demonstrated ability to conquer one export market after another, the obvious question is this: How has China been able to emerge as the world's "factory floor"? The answer lies in China's primary "weapon of mass production"—the China Price. The nine major economic "drivers" of the China Price are as follows:

- Low-wage, high-quality work by a highly disciplined, educated, and nonunion work force
- Minimal worker health and safety regulations
- Lax environmental regulations and enforcement
- The supercharging, catalytic role of *foreign direct investment* (FDI)

- A highly efficient form of industrial organization known as “network clustering”
- An elaborate, government-sanctioned system of counterfeiting and piracy
- A chronically undervalued, “beggar thy neighbor” currency
- Massive government subsidies to numerous targeted industries
- “Great Wall” protectionist trade barriers, particularly for “infant industries”

In analyzing the nine key economic drivers, I show you that *only one*—network clustering—is truly legitimate from the perspective of a global economic system that is supposed to be based on free and fair trade. Each of the other eight China Price drivers violate one or more of the many “rules of the trading road” that have been established by organizations such as the World Trade Organization and treaties such as the General Agreement on Tariffs and Trade or that are embodied in international labor and environmental standards.

The broader point that should emerge from the foundation chapter is that by engaging in a comprehensive set of unfair trade policies and by wielding its primary “weapon of mass production,” the China Price, China is enjoying unprecedented rates of export-driven economic growth—and thereby trouncing the competition in global markets. In the process, China is effectively sowing the economic seeds of the Coming China Wars with the rest of the world. And, in the worst “wars from within” scenario, China is also setting itself up for its own environmental, political, and social destruction.

Low Wages for High-Quality Work

What is stunning about China is that for the first time we have a huge, poor country that can compete both with very low wages and in high tech. Combine the two, and America has a problem.

—Professor Richard Friedman, Harvard University³

It is difficult to estimate accurately wage levels in China because much of the data is of poor quality. In addition, the government wants to hide the fact that numerous companies illegally pay their workers far less than the stated minimum wage.

Estimates that do exist put the average hourly earnings well below a dollar. Interesting, however, is that in many other countries, wages are as low or even substantially lower than in China. These countries, scattered all over the world, range from the Dominican Republic and Nicaragua in Latin America and Bangladesh and Pakistan on the Indian subcontinent to Burma, Cambodia, and Vietnam in Southeast Asia. Despite their lower wages and often equally wretched working conditions, none of these countries can compete effectively with China. One important reason is simply that manufacturers in China get a lot more *productivity* bang out of the wage buck. Chinese workers are relatively better educated and, more important, far more disciplined than the workers found in the poor barrios of Caracas or Rio de Janeiro or the slums of Soweto or Lesotho. This means that dollar for dollar and yuan for yuan, China can provide higher-quality, more-disciplined workers; on a productivity-adjusted basis, their workers are highly competitive with virtually every other country in the world.

There is, however, a far more subtle part of this wage story—one that seeks to answer the question: How is it that year after year, indeed decade after decade of record economic growth, Chinese wages do not really rise much? Or to put it another way, how can Chinese manufacturers continue to pay such low wages for a high-quality work force in the face of rapid growth that in other countries would quickly tighten the labor market and cause wages to spike?

At least part of the answer lies in one of the great ideological, economic, and darkly comic ironies of our time. In a country that was built on a foundation of Marxist doctrine, there exists the largest “reserve army of the unemployed” ever created in human history. In this regard, one of the central tenets of Marxist theory is that the

exploitation of workers by capitalists is made possible because capitalism will always generate significant unemployment. The inevitable presence of this “reserve army” of unemployed workers will always depress wages and allow the capitalists to exploit their workers in other ways, too (for example, poor working conditions).

On this count, and at least at this time in China’s history, Karl Marx got it absolutely right. The size of China’s reserve army is breathtaking and, at least on first hearing, almost unbelievable. This reserve army of surplus labor numbers significantly more than a hundred million workers. To put this in perspective, this means that China has almost as many unemployed and underemployed workers as America employs in total.⁴

Now, here is what is perhaps most interesting about this surplus labor: Despite two decades of double-digit GDP growth, *China’s reserve army continues to grow, not shrink*. The next question is how this huge pool of surplus labor that so effectively depresses wages and benefits in China got to be so large—and why it continues to grow. The answer may be found in four important elements that explain China’s labor market advantage: continued population growth in the world’s most populous country; a massive privatization of the work force that has cast off tens of millions of industrial workers from the security of the “iron rice bowl” system; a government-decreed, rapid urbanization that is moving hundreds of millions of farmers into Chinese factories; and a system, in many cases, of quasi-slave labor facilitated by the outlawing of labor unions.

Population Growth and Privatization

Mao Zedong would shudder at the vibrant free-market energy of Chinese city centres, their rush-hour gridlock, packed restaurants, glitzy shopping malls and young fashionistas chattering on the mobiles they change more often than their shoes. But they are ringed with rusting “iron rice bowls”—the unviable, revenue-draining state-owned enterprises (SOEs)

whose progressive closure is a key to market reform. China has shed 41 million SOE jobs and 21 million more from cooperatives; no wonder it regards America's 6.1 percent unemployment rate dry-eyed. These iron rice bowls provided not just jobs for life, but housing, healthcare . . . , education and pensions.

—*The Times* (London)⁵

As you might suspect, population growth in China has played a critical role in generating surplus labor. In truth, however, two other elements are much more important in creating China's reserve army of the unemployed. The first is the *privatization of industry* as part of China's economic reform process. The second is a rapid rise in *urbanization* of the population—a rise driven in large part by chronic rural poverty.

It is beyond the scope of this book to provide a detailed history of China's economic reforms. Suffice it to say here that prior to these reforms, which began in the late 1970s, the Chinese economy was organized along the lines of an "iron rice bowl." In this Marxist system, all *state-owned enterprises* (SOEs) guaranteed workers not just a livable wage, but also housing, health care, pensions, and other benefits. The system was modeled on the Soviet-style collectivization of industry and embraced by Mao Zedong and the Communist Party shortly after their rise to power in 1949. The big problem with the iron rice bowl system, however, was that it was marked by extreme levels of inefficiency and waste; with their wages and pensions guaranteed, employees in SOEs had little incentive to produce.

Beginning in the 1990s, the Chinese government accelerated dismantling its iron rice bowl system in favor of free market enterprises fueled largely by foreign direct investment (more about FDI later in this chapter). The purpose of what was a rapid and dramatic privatization of much of China's work force was to make Chinese industry competitive with the rest of the world. The practical effect of these

reforms, however, has been to help create the largest “floating population” (*liudong renkou*) of unemployed and underemployed workers ever seen.

Almost all estimates of this vast migration population exceed one hundred million and comprises the largest part of the core of China’s “reserve army of the unemployed.” The reforms are not the only contributor to this army. In fact, prospectively, it will be the Chinese government’s decision to rapidly urbanize its population that will keep this surplus army growing ever larger—and always behind even the most rapid pace of economic growth.

China Urbanizing Imperative

Some say they want to be a driver, a scientist or a teacher. But nobody wants to go on being a farmer.

—Du Nengwei, teacher, Shuanghu, China⁶

Even a wretched job is better than no job . . . Most rural workers find their life in cities bearable because they have hopes and dreams: a color TV, a brother with a college degree, a new house to live in, or even a new apartment in one of the cities.

—Professor Qumei She, Wanli University⁷

Demographer estimates indicate China’s urbanization rate will reach 50 percent by 2030, when China’s total population is expected to jump to 1.6 billion. Factoring in such a calculation, approximately 15 to 16 million itinerant farm workers will annually head to the cities in the next 30 years.

—*The China Daily*⁸

China’s urbanizing imperative is one of the most critical components of the Coming China Wars. It is the result of a huge, fundamental,

and ever-growing disparity between the income levels and prospects of China's massive rural peasantry and the much more affluent and upwardly mobile young urban professional "Chuppies" or Chinese yuppies.

China has so many farmers and so little land that most Chinese farmers have very small plots—often less than an acre or two. This land constraint makes it a virtual certainty that the best most peasants can do is to simply eke out a subsistence living.

Moreover, from a big-picture point of view, the extreme decentralization of Chinese agricultural makes it difficult for Chinese farmers to operate efficiently and create large economies of scale. To understand the problem, consider that in the U.S., less than 2% of the population is engaged in farming, whereas in China more than half the population works in the agricultural sector.⁹ Despite this difference, the grain production in the two countries in any given year is roughly comparable.¹⁰

From the perspective of the Chinese central government, rural poverty is a ticking time bomb, both economically and politically. Economically, a poor and aging peasant population will put tremendous strains on the government's social welfare budget—as these farmers' health and welfare needs must be addressed. Politically, as income disparities grow between the rural and urban areas, so, too, grows peasant discontent. In this regard, the Chinese government is all too aware of Mao's warning that "a single spark can start a prairie fire" and that it was Mao himself who rode into power on a wave of rural discontent.

The broader point is that as a matter of policy, *China has embraced rapid urbanization as a panacea for all its rural ills*. Over the next several decades, the goal of the Chinese government is to move 300 million or more peasants off their small farms and into China's teeming cities and factories. To put this migration in perspective, the number is equal to the entire current population of the United States and *double* the size of the current U.S. work force.

Now here’s the rub: *Even if China continues to grow at a rate of close to 10% a year, China’s reserve army of the unemployed is not likely to shrink significantly and may even swell.* Moreover, if the Chinese economy slows down, unemployment—and political discontent—will skyrocket. Is it any wonder that the Chinese government is so intent on fueling rapid economic growth?

The Final Piece of the Low-Wage Puzzle: Nonunion Labor

Each eyelash was assembled from 464 inch-long strands of human hair, delicately placed in a crisscross pattern on a thin strip of transparent glue. Completing a pair often took an hour. Even with 14-hour shifts most girls could not produce enough for a modest bonus. “When we started to work, we realized there was no way to make money,” said Ma Pinghui, 16. “They were trying to cheat us.”

She and her friend Wei Qi, also 16 and also a Chinese farm girl barely out of junior high school, had been lured here by a South Korean boss who said he was prepared to pay \$120 a month, a princely sum for unskilled peasants, to make false eyelashes. . . . Two months later, bitter that the pay turned out to be much lower, exhausted by eye-straining and wrist-wrenching work, and too poor to pay the exit fee the boss demanded of anyone who wanted out, they decided to escape. But that was not easy. The metal doors of their third-floor factory were kept locked and its windows—all but one—were enclosed in iron cages. . . . Said Ms. Wei, “What they called a company was really a prison.”

—*The New York Times*¹¹

Any complete discussion of China’s low-wage contribution to the China Price must necessarily include the observation that labor unions are banned in China.¹² On the surface, this may seem to be a good

thing to many people. After all, labor unions have earned a bad name in many developed countries—particularly because many unions have used their bargaining power to lock employers into contracts and pension plans that eventually render them unable to compete.

That said, it is equally true from a broader historical perspective of the union movement that when individual workers lack representation on the most basic issues of health and safety, exploitation cannot be far behind. This is certainly true in China, where any form of worker dissent or attempt to organize are certain to be met with beatings, demotions, dismissals (referred to as becoming “fried squid”), and even torture.

In the absence of any union representation, many Chinese workers are forced to endure some of the most dangerous, repetitive, and oppressive working conditions in the world. Part of the problem is a form of corporate organization that has its roots in the commune structure and a culture in which many Chinese have grown up under Communist rule.

In the new capitalist variation, many workers are housed in dormitories, are forced to work 12- to 18-hour days, and are steeply fined if they attempt to take unauthorized vacation time or quit. Predictably, some have likened such dormitories to “slave camps.” It is not, however, locks on the doors or bars on windows that make many Chinese factories “prisons.” In many cases, the chains that bind workers to these factories are real economic needs in the face of a seemingly paradoxical massive unemployment problem and grinding rural poverty.

Lax Health, Safety, and Environmental Regulations

Yongkang, in prosperous Zhejiang Providence just south of Shanghai, is the hardware capital of China. Its 7,000 metal-working factories—all privately owned—make hinges, hub-caps, pots and pans, power drills, security doors, tool boxes,

thermoses, electric razors, headphones, plugs, fans and just about anything else with metallic innards.

Yongkang, which means “eternal health” in Chinese, is also the dismemberment capital of China. At least once a day someone . . . is rushed to one of the dozen clinics that specialize in treating hand, arm and finger injuries, according to local government statistics. . . . The reality, all over China, is that workplace casualties had become endemic. Nationally, 140,000 people died in work-related accidents last year—up from about 109,000 in 2000, according to the State Administration of Work Safety. Hundreds of thousands more were injured.

—*The New York Times*¹³

The Chinese government imposes few health and safety or environmental regulations on its corporations or remaining state-run enterprises. What rules do exist are only weakly enforced, evaded, or simply ignored.

Not surprisingly, the lack of a basic regulatory and legal system is viewed as a great virtue by foreign corporations that want to evade much harsher regulatory and legal regimes in their own countries. Indeed, as China has flapped its *laissez faire* butterfly wings, foreign capital and foreign companies have flocked to its shores—often bringing their own lobbyists to ensure that the rules do not change. In this way, countries as near as Korea, Japan, and Taiwan and countries as far away as the United States have been able to “export” effectively their pollution and workplace risks to China.

Today’s Chinese production facilities are not unlike the Dickensian sweatshops of nineteenth-century industrializing England or the dangerous American factories at the turn of the century that were exposed by the “muckrakers.”

In China’s factories, if the blades or presses do not sever a limb or take a life, the dirt and dust in the lungs or chemicals that seep in

through the skin provide a much slower death. According even to China's own under-reported statistics, China is one of the most dangerous places to work in the world.

For those workers who do lose a limb or fall prey to a work-related disease, no functioning legal system exists to protect them. Upon being injured or maimed, they simply become the detritus of a ruthless manufacturing machine. Because the workers do not receive health care from the state and are unable to extract adequate compensation from their employers, the Chinese (and multinational) companies that grind up and spit out these workers enjoy a cost advantage over countries where workers are better protected.

The Catalytic Role of Foreign Direct Investment

[A] major driver of Chinese productivity gains has been the rapid growth of foreign and foreign-invested firms. These ventures represent foreign direct investment—long-term investments in the Chinese economy that are directly managed by a foreign entity. Close oversight of these operations by experienced foreign managers provides for the transfer of modern technical and managerial techniques, leading to higher productivity levels. In fact, joint ventures of foreign companies with Chinese firms are seven times as productive as state-owned operations and over four times as productive as domestically run private enterprises.

—The U.S. Conference Board¹⁴

[A]s capital floods in and modern plants are built in China, efficiencies improve dramatically. The productivity of private industry in China has grown an astounding 17% annually for five years.

—*Business Week*¹⁵

Cheap labor and lax health, safety, and environmental laws are giving China a direct competitive edge over many other nations, particularly in the developed world. However, these elements of the China Price also have indirectly helped attract a massive inflow of catalytic *foreign direct investment* (FDI). Since 1983, FDI has grown from less than \$1 billion a year to more than \$60 billion, and it is projected to soon reach \$100 billion annually. The lion’s share of these funds comes from five main sources: Hong Kong, the United States, Japan, Korea, and Taiwan.

The FDI influx provides Chinese companies with two incredibly powerful catalysts for honing their competitive edge. First, this FDI is being spent on the most sophisticated and technically advanced manufacturing processes available. Such technology transfer means that China is getting much better equipment and machinery much sooner than other developing countries, which allows Chinese manufacturers to always produce more efficiently on the cutting edge. These FDI efficiencies are reflected in dramatic double-digit rates of productivity growth over the past decade.

Second, the catalytic FDI has brought with it some of the best managerial talent and managerial “best practices” from around the world. The result has been a winning combination: cheap Chinese labor on the production lines and local Chinese “scouts” who use their connections (known as *quanxi*) to grease the bureaucratic wheels coupled with the *crème de la crème* of foreign managerial talent in the middle and upper ranks.

Network Industrial Clustering in China’s Ultimate Pin Factories

National and regional economies tend to develop, not in the isolated industries, but in clusters of industries related by buyer-supplier links, common technologies, common channels

or common customers. The economies of the Pearl River Delta region are no exceptions. The region has developed a broad range of clusters in garments and textiles, footwear, plastic products, electrical goods, electronics, printing, transportation, logistics, and financial services. The Pearl River Delta region's electronics and electrical cluster is particularly strong and accounts for the vast majority of Chinese production in a wide range of industries.

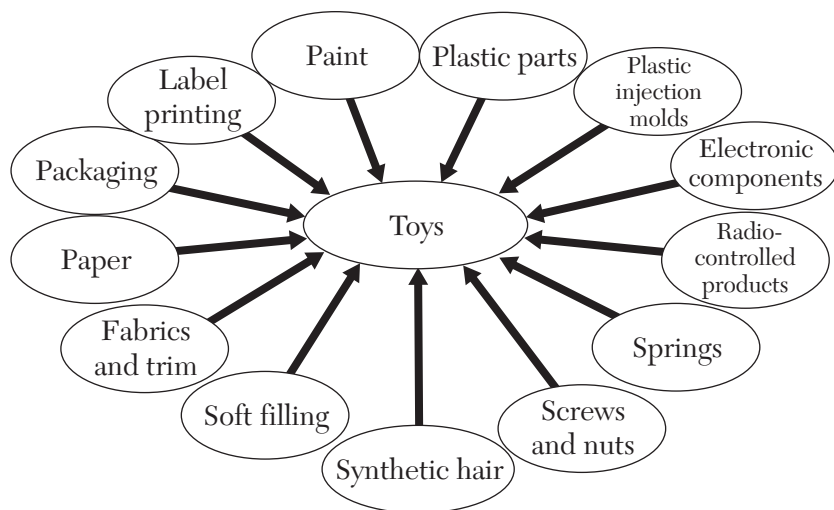
—*Regional Powerhouse*¹⁶

The world can rightly howl about the unfairness and illegality of many aspects of the China Price—whether it be lax pollution controls or the many and various mercantilist trade policies discussed shortly. However, what no one can legitimately complain about—and what every business executive and bureaucrat can learn from—is China's incredible “industrial network clustering.”

For the production of a wide range of China's export goods, companies located in close physical proximity to one another have formed highly synergistic networks and clusters of activity that yield significant economies of both scale and scope. In doing so, these industrial network clusters have become the modern embodiment of Adam Smith's famous pin factory, where an extreme division of labor and hyper-economic efficiency both rule.

To understand the nature of these network clusters, take a look at the figure on the following page from the book *Regional Powerhouse*. It illustrates the famous toy cluster in Guangdong Province. This province, located in the Pearl River Delta along with Hong Kong and Macao, has effectively cornered the world market on toy production.

You can see in this figure that every single factor needed for toy production is produced in close proximity to the major toy manufacturers. These factors of production range from packaging, plastic parts, paint, and label printing to springs, screws and nuts, soft filling, and synthetic hair.



The famous toy cluster in Guangdong Province

Perhaps what is most impressive about the clustering is that it is often done by whole townships or cities. In an extreme and extremely efficient modern version of Adam Smith’s specialization of labor, China features *entire cities or towns* that specialize in particular industries or industry segments.

For example, in Guangdong Province, the city of Huizhou is the world’s largest producer of laser diodes and a leading DVD producer. Foshan and Shunde are major hubs for appliances such as washing machines, microwave ovens, and refrigerators. Dongguan’s Qingxi Township is one of the largest computer production bases in China. Hongmei focuses on textile- and leather-related products, Leilu on bicycles, Chencun on flowers, Yanbun is the underwear capital, and so on.¹⁷

The result of industrial network clustering is the generation of tremendous synergies and economies of scope along the supply chain. In this regard, it is worth noting how similar—yet so different—this form of industrial organization is to the kind that triggered the vaunted Japanese miracle of this past century.

During the 1980s, Japanese industry made famous the use of “just-in-time” systems in which the various parts necessary for production arrive from all over the world just in time for assembly and manufacturing. This type of uniquely Japanese manufacturing, borne of geographic necessity, dramatically cut inventory costs.

The Chinese have taken this system one level higher because it has been able to transform quickly whole cities and towns and tens of thousands of acres of “green field” farmland into industrial production sites. In their industrial network clustering model, Chinese manufacturers do not have to rely on an elaborate and globally dispersed supply chain as the Japanese do to bring in all the various parts to produce the whole. Instead, most of the various factors of production are located in close proximity in any given industrial network cluster, providing great savings in transportation and transactions costs and accelerating the spread of knowledge sharing.

Rampant Piracy and Counterfeiting

China is the epicenter of the counterfeits boom . . . Just a few years ago, counterfeiting was all Gucci bags and fake perfume. Now it's everything. It has just exploded. It is many times larger a problem than it was only a few years ago. The counterfeit inventory ranges from cigarette lighters to automobiles to pharmaceutical fakes that can endanger a life. I would bet that there are companies in this country [the U.S.] that don't even know they're getting screwed around the world.

—Frank Vargo, VP of International Economic Affairs
National Association of Manufacturers¹⁸

Chapter 6, “The 21st Century Opium Wars—The World’s Emperor of ‘Precursor Chemicals,’” describes in detail the breathtaking scope of China’s government-sanctioned counterfeiting and piracy.

However, two brief points related to the China Price are worth noting here.

The first is obvious: To the extent that China’s entrepreneurs use counterfeit or pirated factors of production—such as pirated software on their computers—they are able to cut significantly their costs relative to countries where intellectual property rights are respected.

The second point is equally important. The piracy and counterfeiting that exists in China is largely the result of a tacit government policy to allow such practices to flourish. China has a relatively comprehensive set of antipiracy statutes on its books. However, little or no enforcement exists, and what fines and punishments do exist serve as only weak deterrents.

The reason for China’s tacit sanctioning of widespread counterfeiting and piracy is that the Chinese government is well aware of two things. Counterfeit and pirated goods sold domestically help keep inflation low, and selling these goods internationally creates jobs and export revenues.

Beggaring Thy Neighbors with a Chronically Undervalued Currency

China’s undervalued currency encourages undervalued Chinese exports to the U.S. and discourages U.S. exports because U.S. exports are artificially overvalued. As a result, undervalued Chinese exports have been highly disruptive to the U.S. and to other countries as well, as evidenced by trade remedy statistics.

—U.S.-China Economic and Security Review Commission¹⁹

On the one hand, countries such as the United States and Japan as well as the European Union abide by “floating exchange rates” in which the values of the dollar, yen, and euro are determined in the

free market. Thus, when a country such as the United States sees its trade deficit rising with either Japan or Europe, the value of the dollar will tend to fall relative to the yen and euro as dollars pile up in foreign banks.²⁰ This weakening of the dollar makes imports into the United States more expensive and U.S. exports more competitive. In this way, free-market forces in the world's currency markets help bring global trade flows back into balance.

China, on the other hand, has adopted a “fixed exchange rate system” in which it pegs the value of its currency, the *yuan*, to the value of the U.S. dollar.²¹ The result, as Chinese imports have flooded into the United States, has been a large undervaluation of the yuan relative to the dollar. The most reliable estimates put the size of this currency undervaluation at anywhere from 15% to 40%.

As a practical matter, China's “fixed-peg” system means that *no matter how big a trade deficit the United States runs with China, the dollar cannot fall relative to the yuan*. This fixed peg also gives China a big advantage over much of the rest of the world—from Europe and Asia to Latin America—when it comes to accessing lucrative U.S. markets. Accordingly, China's “beggar thy neighbor” currency policy is an important engine of its export-driven growth.

Massive Subsidies and the Great Protectionist Walls of China

Under state control, many Chinese state-owned manufacturers are operating with the benefit of state-sponsored subsidies, including: rent, utilities, raw materials, transportation, and telecommunications services. That is not how we define a level playing field.

—U.S. Department of Commerce Secretary Donald Evans²²

China's state-run banks have routinely extended loans to state-owned-enterprises that are not expected to be repaid.

And right now, the big four state banks in China are, for all practical purposes, insolvent.

—U.S.-China Economic and Security Review Commission²³

As part of its broader mercantilist trade strategy, China has constructed a “Great Wall of Protectionism” around both its agricultural and industrial sectors. One of its two-pronged protectionist strategy involves a complex web of direct and indirect subsidies, particularly to promote key “pillar industries.” The second involves an equally complex set of trade barriers that provide shelter to some of China’s most vulnerable domestic industries and agricultural sectors.

In this regard, both energy and water are heavily subsidized, and cheap electricity is a significant cost advantage for China’s steel plants and heavy industry. At the same time, its state-owned enterprises, which still control key sectors of the economy such as oil and steel, benefit from free land; other enterprises are given preferential access to land by local and regional governments.

In addition, China’s state-run banks provide heavily subsidized capital and credit to Chinese enterprises. These banks currently and collectively have on their books tens of billions of dollars in loans without any expectation of repayment—essentially free money! Finally, on the subsidy side, many industries in both high-tech sectors such as biotech, electronics, and computers and middle-tech sectors such as autos and aircraft receive direct and substantial R&D support from the government.

It is not enough that China’s government seeks to provide its export industries with every possible advantage. Its government seeks to protect many of its domestic sectors. Such protectionism is achieved through a labyrinthine set of tariff and nontariff barriers.

For example, on the agricultural side, China has imposed so-called tariff-rate quotas on a wide variety of bulk commodities such as wheat, corn, cotton, and vegetable oil. Such tariff-rate quotas involve tariffs that rise with the level of imports.

On the industrial side, China has similarly used unjustifiable and idiosyncratic technology standards to build walls around its software, mobile phone, DVD, wireless networking, and other industries. In addition, it has used preferential tax treatment to promote and protect key industries such as semiconductors, limited access to domestic market channels, and imposed excessive capitalization requirements on foreign financial services.

Of course, in the wake of China's entry into the World Trade Organization in 2001, these subsidies and protectionist measures were supposed to melt away. However, China's compliance with both the letter and spirit of the WTO has turned out to be as big a farce and fiction as much of what appears in the heavily censored and, for the most part, state-controlled Chinese press. China is the reigning emperor of antidumping complaints against its industries, while China's Great Wall of Protectionism provides significant cost advantages to numerous Chinese industries.

Summing It All Up

In this foundation chapter, we have examined the nine key drivers of the China Price. Clearly, the ability of Chinese entrepreneurs to offer the China Price across an incredibly diverse array of industries is China's premier weapon of mass production—one that is at the root of China's conquest of one export market after another.

The remaining chapters demonstrate how China's export-led hyper-growth is, in turn, spawning a thousand different points of conflict in the Coming China Wars. And no conflict may be more sharp and bloody than the one examined in the next chapter.