

# The Future of China as a Leading World Consumer:

US Investments in China's Retail Sector

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In recent years, China has emerged as a retail powerhouse. After the economic downturn in information technology, American and foreign investors have been trying to diversify and still take advantage of the new opportunities in China right now. China's cheap labor, large market, and growing economy are the ideal conditions for American companies to capitalize on. China has an almost endless supply of labor, practically a flat supply curve, which also means low costs of labor. This large growing population also guarantees a huge consumer market for manufactured goods. Retail is one of the few sectors in Asian that has been experience steady and increasing growth every year due to increased buying power of its citizens, and if this trend continues, China will become one of the world's largest consumers. Although, there has been a rough past of US-China trade relations, profitability in the future lies in cooperation between the two countries.

### **Reasons for US surge of investment into China**

China is currently in the fortunate position of receiving billions of US dollars from foreign investors including the US. A recent announcement in January 2003 valued overseas

investment to China at \$52.7 billion US dollars in 2002. This was a 12.5 percent increase from the previous year (People's Daily). The numbers were compiled by one of China's many economic organizations, the Ministry of Foreign Trade and Economic Cooperation (MOFTEC). The number of newly-approved overseas ventures also increased dramatically in the last year. There was a 30 percent increase from last year to 34,171 ventures (People Daily). China joined the World Trade Organization at the end of 2001, and this is still credited as the main driving force behind its most recent surge of overseas investments into China (WTO). Analysts in MOFTEC claim, "China's huge market potential is being unleashed, its infrastructure and policy environment have greatly improved, and its relative advantage in labor and resources is gaining world attention." Currently, there are at least 420,000 foreign invested ventures in China worth more than \$440 billion US dollars (People's Daily). MOFTEC Minister Shi Guangsheng is extremely optimistic in regards to his country's economic situation, predicting that investment may grow even higher this coming year as "China has the most ideal market, labor force, and environment in the world." (People's Daily). While this official's statement is biased and exaggerated, the incredible growth rate of foreign investment is undeniable.

China's extraordinary economic growth has been the main fuel behind the surge of US investment into China. American investors are seeing endless possibilities in this untapped market. Furthermore, all economic reports suggest that in the next few years, China will be able to maintain its growth levels. In "The 2002 APEC Economic Outlook", the Economic Committee of the Asia-Pacific Economic Cooperation (APEC) reported that the Chinese economy should remain strong throughout 2002 and 2003. Not including the recent effects of the Sever Acute Respiratory Syndrome (SARS) epidemic, "exports and industrial production" should continue to grow APEC members.

“Especially China and Vietnam are expected to register around 7 percent of GDP growth. Thanks to the rebounding private demand and big boost from the government sector, China’s economic condition should remain healthy in 2002 and 2003.”

“The 2002 APEC Economic Outlook”  
(China Building 2003)

Weakness in the US dollar and China’s relatively recent entry into the WTO has improved its position in obtaining foreign investment. The drop in stock prices and value of the US dollar in mid-2002 have slightly shaken market confidence, but Chinese officials are quick to reassure the public that these events will not lead to another recession. The APEC Economic Committee expects the US economy to experience a shallow slowdown and then a gradual return to the expected growth path and full recovery. They also hope that the improving US economy will help strengthen the economies of Southeast Asian member countries.

In addition to receiving increased foreign investment, China is also increasing trade with the ASEAN states. Since China entered the WTO, the annual trade volume between China and the ASEAN nations has increased by an annual average rate of over 15 percent. China is now ASEAN’s 6<sup>th</sup> largest trading partner, and the ASEAN nations are China’s 5<sup>th</sup> largest trading partner (China Building 2003). In the first 3 economic quarters last year, the trade volume between China and ASEAN totaled over \$38 billion US dollars, an increase of 27 percent compared to the previous year (China Building 2003). Trade officials at the first Macro-Economic Forum on China and ASEAN in Kunming, China, announced the figures in 2002 to a group of economic officials from the 11 nations. Almost all were very enthusiastic about the great potential for increased growth in trade between the nations. Both China and the ASEAN have large untapped markets and huge populations.

“China has provided a great market for ASEAN Member States in recent years due to its rapid economic growth and improved purchasing capacity. Meanwhile, China’s WTO entry has also increased opportunities for ASEAN states to enter China’s market. Malaysia’s current export volume to China has increased seven-fold compared to 1991, while the import volume has increased six-fold.”

- Allauddin Anuar

Senior economic official from Malaysia  
(China Building 2003)

The growth rate is expected to increase for the next several years, almost ensuring that investments in the retail sector will likely flourish.

### **Criticisms on the effects on Worldwide Deflation and Labor Wages**

Many economists have argued that US investments in China have indirectly led to worldwide deflation due to China’s seemingly endless supply of labor and low labor costs. Stephen Roach, a director of Morgan Stanley argued, “China had been shifting its own deflation to the world, by exporting cheap commodities” (Chinese Embassy in UK). He also claimed that the global economy was facing “its highest risk of deflation in 70 years” (Chinese Embassy in UK). This comment was made in October of 2002, and since then, many Chinese economists have risen to China’s defense. The original reasoning behind Roach’s claim was that American manufactures move their production to China, where facility and labor costs are 20 to 30 percent lower than in the US (TCD Trade). The lower costs equate to lower product pricing and

therefore, deflation. When the goods are exported, they spread deflation worldwide, and thus China is held accountable for global deflation.

However, there are at least two flaws in this logic- China is not responsible for setting the prices of goods sold internationally by foreign companies and Chinese exportations only account for a small fraction of total exported goods worldwide. When manufacturing companies build factories in China, they are benefiting from the lower cost of labor and supplies, but these costs are not necessarily passed on to the consumer. The companies simply make bigger profits. The Chinese manufacturing plants do not and cannot have any control in the final price of goods produced. The other reason China cannot solely be responsible for global deflation is because China does not export enough goods to make a significant impact on prices. Recently, China's exports and its share in global trade have significantly increased, but it is nowhere near the production power of the top 3 exporters- the US, Japan, and Germany. Even with China's dramatic growth levels, it is still far behind the top 3 (Chinese Embassy in UK). In 2001, the WTO reported that Chinese manufactured goods only accounted for 5.3 percent of total world exports (WTO). A large portion of these items were parts and components for electronics that would not affect the overall pricing of the final product. Of the fraction that were final goods, most were produced for China's own growing domestic market. Therefore, China's competitive labor costs are only partly passed on the final consumer, and China cannot be blamed for influencing worldwide deflation.

While American businesses flocked to China for its low labor costs, Americans back home in the 1980's and 1990's complained about the adverse affect on the US labor market. Contrary to public perception, increased investment in China by US companies did not take away jobs from Americans, at least not nearly to the degree portrayed in the media. In fact,

almost 90 percent of the US companies that expanded production into China maintained their level of production in the US (Fung). In many of those cases, the total manufacturing abilities of the companies grew, and workers at home in the US were *not* adversely affected. Of those companies that expanded into China, almost 40 percent also expanded output at home (Fung). Furthermore, many of those companies diversified their product manufacturing when they built or bought factories in China. A portion of the items being produced in Asia were completely different items than the ones being made in the US. Again, the actual effect on US manufacturing was grossly over exaggerated by the press.

### **Retail as future area of investment**

One of the foremost reasons for investors to look into retail, as opposed to other possible areas of investment, is the strong and steady growth of the entire sector in the past several years. In 2002, domestic retail sales in China averaged 8.7 percent year on year (China Building 2003). These figures come from the most reliable source of statistics in China, the National Bureau of Statistics (NBS). China's growth rate of 8.7 percent is relatively very high compared to the US, where the growth rate of retail sales has been hovering between 3 and 4 percent in the last 3 years.

More detailed statistics from the NBS reveal that general purchasing power of low-income urban dwellers has increased, leading to increased sales in daily items. Sales of food, clothing, and daily necessities grew by 14.1 percent, 11.1 percent, and 17.7 percent respectively (China Building 2003). The growth rate in cities was substantially higher in cities compared to rural areas, showing that the majority of new purchasing power is coming from urban consumers.

Retail sales in urban areas such as Beijing and Shanghai surged in 2002 at an 8.8 percent growth rate. Retail sales in rural areas grew only 6.8 percent last year (China Building 2003). Part of the reason, may be due to the growing number of retail chain stores in urban areas. As fast as China is developing, many rural areas still lack modernized stores. Consumers may be limited to purchasing items from local vendors in cash, where the transactions are not as dutifully recorded. These rural areas are still an untapped market for American companies to build and invest in.

### *Population growth*

As is commonly known, China has over 1.28 billion residents, as of 2002, making it the most populated country in the world. Over 20 percent of the world's 6 billion people live in China, and 36 percent of those live in urban areas (Huus). Even with the one-child per family policy, the average birth rate in the cities is a little above 1.2, also making China one of the fastest growing countries in the world. Over 14 million babies are born every year, which is more than the population of the state of Florida. In rural areas, the birth rate is as high as 2.5 because farmers feel the need to have more than one child to help the family with farming and chores. At the current rate, the population is expected to grow to 1.6 billion by 2050 before slowing down growth (Huus). Part of the dilemma right now is that even with the infamous one child rule, there number of childbearing women is at about 350 million right now (Huus). With this large of a number, the birth and death rates will not be level for decades. Entrepreneurs have looked at this growing population as a new dream market. China is a developing nation- people are buying private cars, building skyscrapers, using more resources, and buying more products than ever before.

## *Shopping culture*

In Asia, shopping is a cultural pastime. It is a completely different way of life from the US. Anything and everything is for sale. Although, shopping as a social habit is more popular in Hong Kong and Japan, the desire to shop is strong for all Asian countries. Giant shopping malls and department stores populate the cities where the main event on weekends is well, shopping. Hong Kong and Japanese prices have been notoriously high for decades, and Chinese cities like Shanghai and Beijing are catching on.

Japanese stores like “Busy Work Shop”, “The Milo Store”, and “A Bathing Ape” typically set the trends in fashion, design, and even store architecture. Designer Masamichi Katayama has 37 shops in Japan with several in Harajuku-Aoyama, Tokyo’s fashion and design district. He designs each of his shops with a different theme- all unique and futuristic. One has a “Blade Runner” theme while another seems more inspired by “A Clockwork Orange.” His stores are designed to be experienced independent of what is being sold, which would make browsing and “window shopping” an activity as opposed to actual purchasing. His stores are designed purely on whim and fancy; he designs often completely disregard studies performed by retail anthropologist Paco Underhill. These typical guidelines are used at American chain stores such as the Gap and Macy’s. They include consumer behaviors such as the predisposition to turn right after entering a store and it takes them up to 15 paces to slow down and decompress after entering. In Katayama’s stores, T-shirts are displayed in Plexiglas cases, cologne in deli cases, sneakers on a carousel similar to an airport luggage carousel (Rakoff).

Even with the economy at record lows, business in Harajuku-Aoyama is booming. Katayama claims that most mornings crowds line up outside to enter his stores. The district is generally packed, but whether or not crowds are buying is a different question. The inflated prices carry the high cost of owning a boutique in the expensive area and designing each new store to catch the consumer's eye. "You're not just buying the product. You're also buying the time you spend" (Rakoff). The stores cater to a young crowd in their teens and 20's. After school, high school students will come one of his many stores and view the clothing as if viewing museum pieces. This browsing will be their activity for the entire afternoon.

One striking cultural difference between Asian and American families gives Asian youth the disposable income to indulge in the latest trends. In Asia, including China and Japan, it is typical for the son or daughter to live with the parents until they marry. So even after a student graduates and starts working full-time, they often live at home with their parents. This frees up a considerable amount of disposable income for all members of the family. Even after savings and the inflated living costs of Chinese cities, the younger working generation has money to burn.

### **Benefits of US investment**

Walmart is the arguably the best example of American companies expanding into China and benefiting the areas more than they harm local trade. Their public statement includes promises such as "local buying" and "every day low prices".

"Wal-Mart has been committed to improving the living standard and consuming habits of the local consumers, generating economic development and stimulating consuming demand with its advanced computerized management, modernized facilities, and brand-new retailing concepts."

- Lee Scott  
President & CEO, Walmart Stores  
(Wal-mart China)

In addition to providing competitive prices for Chinese consumers, Walmart has also taken steps to benefit the local communities. The “Local Buying” concept means that Walmart obtains the vast majority of its products from local providers. At the China locations, the company sources 95% of its merchandise from local companies (Wal-Mart China). While many Chinese conservative economists feared excessive importing when Walmart first opened its doors in 1996, their fears have been quieted since.

In addition to supporting local companies in China, Walmart has also helped these small firms expand globally. In 2002, Walmart China purchased over \$12 billion in US dollars to sell in China and also export to its other stores (Wal-mart China). The company expects that amount to grow substantially in the next few years. Last year’s figure, \$12 billion, is almost two-thirds of the total amount Walmart spends overseas (Dicus). In the next 5 years, they expect that figure to more than double and account for the vast majority of money spent overseas (Dicus).

The best example that Walmart is setting for future American enterprises in Asia is its devotion to community service in the local areas. In 2002, Walmart and its associates collected a total of 2.6 million RenMinBi, which equates to a little over \$300,000 US dollars (Wal-mart China). The money was donated to more than 40 different charities in the local areas of each Walmart branch. Currently, China only accounts for 5 to 6 percent of Walmarts total yearly sales, so there is much room for growth (China.org). Other companies that are jumping on the bandwagon and expanding into China include the Home Depot, the second largest American retailer, and General Electric.

In conclusion, retail is a top area of promise for American and foreign investors in China. The recent surge of investment will only strengthen the growing economy and keep it stable even through economic downturns and shocks to the economy like the recent SARS epidemic. Almost all Chinese economic committees agree on the steady growth in the past several years and attribute it to China's entry into the WTO. Continued presence in the WTO and trade with ASEAN will only bolster already growing sales. Complaints of worldwide deflation and stealing away American jobs have only very little validity to the claims. They generally have been over-exaggerated by the media. Retail sales only look to increase in the near future. China's large and growing population and obsession for shopping practically guarantee profits for investors. Large American companies like Walmart and Home Depot have already started expanding into China with great success for both sides, and is very indicative of the future of retailing for both America and China.

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