

# China: Arrogance and development



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I heard about it, read about it, but never had a chance to experience it first hand. Then the day came. The place was Zurich, Switzerland. The event was an Asian investment conference organized by an established investment group. They brought in a team of fund managers from Asia to sell their products. One was a young lady from China. To a group of global investors she showed a slide with red hammer and sickle plus the pictures of the current and future leadership of China. She extolled the virtues of an orderly transfer of power without all the problems of appeasing voters.

Showing demographic charts of age indicating dire problems as a result of the one-child policy on China's growth, inflation and rising costs, she talked about how all signs are positive for continued growth. Then she talked about China's massive infrastructural development and great high-speed rail projects. No other country has such a growth in infrastructure. Again she lauded the rail system and compared it to the newly announced small rail program for California.

After the presentation I went to her to save face for her with the attendees

and cautioned her not to offend her guests at the conference, many of whom are familiar with the experience of Siemens and Germany in China. And, although it will be tough, California will at least pay for its trains and technology. I also reminded her that there were attendees in the room who knew China well and had a much longer perspective on the country than she could have experienced in her tender years. When I was finished she responded with a nice smile that I had not seen since my experiences in Eastern Germany shortly after the reunification of Germany.

There is a new arrogance and anti-Western trend in China, particularly among the young, who do not remember and do not know about the Great Leap Forward or the Hundred-Flowers Campaign and consider the West and western values as old and capitalism as an outdated model.

The young have known only growth and success. They look west and see a system in chaos, which only supports their opinion. However, in that arrogance lie the seeds of the end of the economic miracle they have experienced in their early careers. China has come far in the last 20 years. If anything, that is an understatement. Its economic success is without question.

However, one needs to look at the arrogance and "tone-deaf" speeches to a group in the center of capitalist investment to see that the overreach and blindness found in European communist systems that crashed and burned, are now creeping into the Asian experience. Shortfalls in population, lack of arable land to feed the population, inflation and the energy needed to keep the largest population of the world on the same track are daunting, but can be overcome. However, it will not be done with the mindset we experienced in Zurich.

Western investors are realizing that China is a closed shop and they are on the outside looking in. Approximately 10 trillion dollars left the United States since 2001. Approximately 7 trillion

went to Asia. This global capital will not suddenly stop, but the flow has started out of Asia into Latin America and certain countries in Africa. They are now experiencing the same rapid growth as Asia in the early years, and to use a capitalist phrase: money flows where it is best used.

The cost of labor in a depressed U.S. economy is now equal and lower to the cost of labor in many parts of China. The wage costs will continue to grow as the wage demands in China are rising every week. The same goes for the other costs of industrial growth, including healthcare and environmental and workplace safety. This is only normal in a culture transitioning from production to consumption. How they pass through this phase will be the real key to their future.

The Chinese have also always hidden behind their currency valuation to maintain their growth. With the strong Swiss franc it is easy to understand what can happen to an economy that has a 40% currency undervaluation. While this undervaluation declines over time, the problem is growing that Chinese companies must find lower cost locations for manufacturing. Therein lies another trap. Many Chinese entrepreneurs are just as lost outside of China as we are inside China. They only know their system, which is radically different from our competitive free-enterprise model.

Much of the future success for China will lie in its ability to adapt to its new consumer economy, higher wages, social and environmental needs and all those issues western societies have been dealing with for some time. There will be significant challenges ahead for China, given their demographics and other structural problems. However, they will certainly fall short of their visions of success if the anti-western arrogance is allowed to continue. If you doubt this trend, just ask a young person about his iphone... Then you know China has far to go to become a truly developed country and to match its success of centuries gone by.

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