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International

Foreign Companies Shy Away From China

Oxford Analytica 07.27.10, 6:00 AM ET

Foreign companies are becoming more concerned by what they see as barriers to market entry and unfair treatment in China. Furthermore, in a departure from past practice, prominent corporate figures have been making their criticisms known publicly. In the *Financial Times* China's Minister of Commerce Chen Deming characterized China as a market that has become increasingly open, remains attractive to foreign investors, and is responsive to foreign concerns and good for the global economy.

Domestic markets. As the era of manufacturing in China for export by multinational companies is coming to a close, and manufacturing in China for Chinese consumers is the growing incentive to be there. However, corporate executives are becoming increasingly concerned by what they say are barriers preventing their entry into the market.

Outspoken critics. General Electric (GE) CEO Jeffrey Immelt reportedly expressed concerns about China and uncertainty as to whether China wanted companies to be successful earlier this month. Immelt later expressed doubts about whether he had spoken as bluntly as reported, thereby triggering a media flurry within and outside China. Indeed, foreign businesses usually avoid talking openly about problems they have in China; backroom negotiation is preferred and press attention typically not welcome. However, Jurgen Hambrecht, chairman of BASF, and Peter Loescher, chief executive of Siemens, went further in breaking the unspoken rule when they met Premier Wen Jiabao, alongside German Chancellor Angela Merkel, on July 19. It is highly unusual for foreign visitors to criticize Beijing's policies in front of senior Chinese leaders on a public occasion, yet both complained about the need to transfer technology to Chinese partners for deals to go ahead, obstructions put up against them in getting access to the Chinese domestic market, and intellectual property violations.

Response. China's official news service, Xinhua, was quick to respond. On July 20 it highlighted that, contrary to negative assessments about China's business environment, foreign direct investment (FDI) in China had jumped by 19.6% year-on-year in the first half. It noted how much promise Chinese companies saw in the 'consumption boom' China offered.

Less favorable regime. Part of the issue is that China has slowly reduced its favorable treatment for FDI, with tax breaks and other perks now largely phased out. While they still want foreign investment, provinces are becoming much more picky about the kind of investment on offer, and they have fewer policy tools to encourage investors to come.

Changed game. Furthermore, the game is changing. Investment has transformed regions such as Guangdong and Fujian into the world's largest suppliers of items such as microwaves, electronic goods and toys. Labor disputes this year are the latest reminder of pressures that are pushing costs up, and there no longer appears to be the limitless pool of cheap labor that there once was. This has had a knock-on effect on prices.

Foreign manufacturers have also had to deal with the tougher employment regulations in the Contract Law of early 2008. Companies are caught in a quandary:

--China is no longer the cheap manufacturing base it used to be; but

--there is no easy alternative destination boasting factories on such a scale and good links to the international supply chain.

Outlook. Foreign investor frustration will continue to build up in the short- to medium-term, and the two long-term challenges for the Chinese economy remain essentially unchanged:

--The Chinese continue to save too much, and spend too little, despite all the work of their government to make them change.

--Internationalization of the Chinese economy is trapped while the renminbi remains non-convertible.

Making fundamental policy decisions about such issues is still crucial for China's economic development. It can continue driving large GDP increases, but how it creates a higher value and more sustainable economic model remains the challenge.

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