Wall Street Journal
December 11, 2006; Page A1

China's Shifting Growth May Alter Its Taste for Foreign Investment

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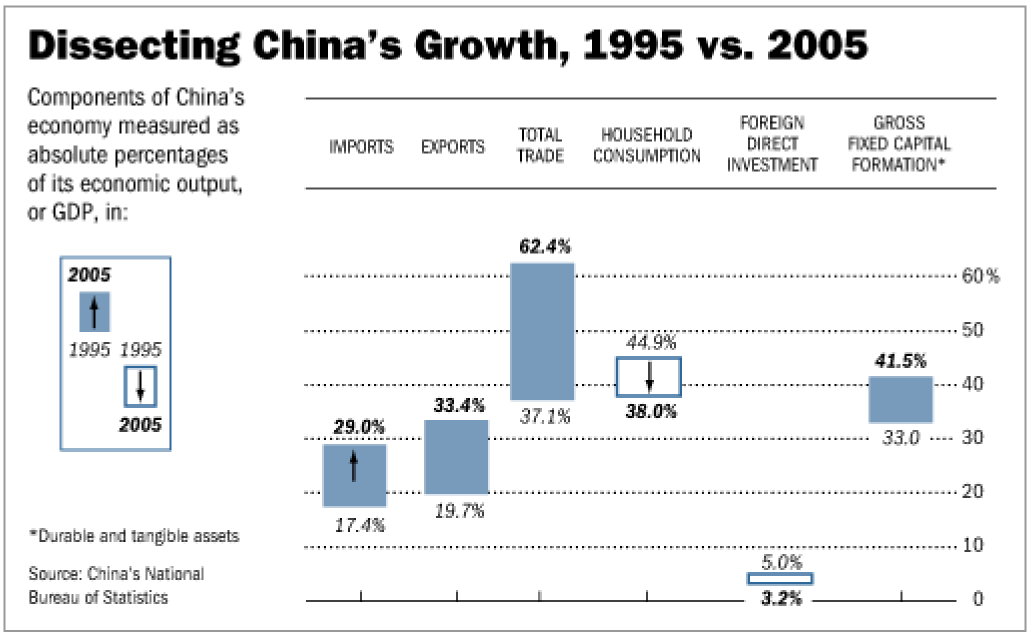
BEIJING -- China's entry into the World Trade Organization, five years ago today, sparked an economic expansion that is the envy of the world. But now, that very growth is posing new problems for China and its increasingly uneasy trading partners.

Over the past five years, the size of China's economy has nearly doubled, with annual output surpassing $2 trillion in 2005. The world's most populous nation is now its fourth-largest economy and third-largest exporter.



Labor Secretary Elaine Chao talks about the key issues she and other top Bush administration officials plan to discuss in their upcoming trip to China. China's WTO entry did what officials inside and outside the country were hoping it would -- increase trade and make markets more competitive. By becoming more open, China has become stronger and more prosperous. But the growing size and sophistication of its domestic economy have made the outside world less important to China's economic vigor now than it was during the early years of the country's export boom. That raises an important question: Will China continue to be ever-more welcoming to foreign investment in the years ahead?

Even as China has begun to take a more active role in international affairs, its economic strategy has shifted inward. It is increasingly trying to nurture homegrown companies, rather than simply providing an attractive climate for multinational corporations to set up shop.

There's an emerging consensus among the nation's leaders that China no longer needs to cater to the whims of foreign investors in order to grow. That shift in sentiment was underscored earlier this year when China's economic planners called for more-selective approval of foreign investment and fewer giveaways, such as tax breaks or land.

U.S. Treasury Secretary Henry Paulson's scheduled visit to Beijing this week is part of a continuing effort by China's trading partners to deal with this new reality.

When China won the WTO's seal of approval in late 2001, it was a signal to the world that Beijing wasn't going to turn its back on capitalism. That sent a flood of foreign investment sweeping into China, surging from roughly $40 billion annually in the years before 2002 to more than $70 billion last year.

China's economic ascendance hasn't been altogether comfortable for much of the rest of the world. The addition of China's vast, low-cost labor pool to the global work force has put widespread pressure on jobs and wages in many wealthier nations. It often seems to employees of U.S. and European companies that their bosses prefer to hire workers to make things in China rather than use their home-country assembly lines.

In some ways, the change has also been painful for China. As it has phased out state control of its economy, China has dismantled much of its health-care and social-welfare system and laid off millions of workers from state-run companies. Competition from foreign companies sometimes gets the blame for the resulting social problems.

Even so, China has largely adhered to its WTO commitments, though some critics say it hasn't been aggressive enough in combating copyright piracy or letting market forces influence its currency's foreign-exchange rates.

And while complaints about China's trading practices are rife, it is also clear that China's economy is in many ways more open than Japan's was during its rise in the 1980s and India's is today.

Japan was once notorious for the difficulty foreign companies faced in penetrating its maze of tariffs and regulations. Even though it is much more open now, imports still account for only about 11% of the country's gross domestic product. The equivalent figure for China was 29% last year.

Compared with India, China's greater openness is visible at street level. Wal-Mart Stores Inc. outlets are fixtures in every major Chinese city. The U.S. discount retailer now has 66 stores in China and is building more -- but it has yet to open a single outlet in India, where government rules ban most direct foreign investments in the retail sector.

The regulatory overhaul that China undertook to meet the requirements of WTO membership meant allowing new competition in industries long dominated by state-owned firms. Among other things, that process jump-started financial restructuring. Four of China's five biggest banks now trade on international stock markets and boast big foreign shareholders.

Not every industry is equally open, and some openings have had unanticipated consequences. Take cars, which very few of China's private citizens owned when the WTO pact was signed. Then-U.S. Trade Representative Charlene Barshefsky, explaining the benefits of a WTO deal in April 2000, noted how "a combination of trade barriers and industrial policies makes it virtually impossible to export cars to China." The country subsequently removed many of those barriers, and auto sales boomed as car prices fell.

The boom came so quickly that infrastructure and public transport haven't kept up: Major cities are now choked with traffic and smog, especially Beijing, where a car's average speed can be slower than a bicycle's at peak hours.

What didn't happen, however, was a boom in car exports to China. China did buy more cars from abroad -- 143,000 vehicles in 2005, compared with 61,000 in 2001 -- but most of the market has gone to locally made vehicles. Passenger-car sales are expected to top three million this year, up from fewer than one million in 2001. The Chinese market's combination of huge size and rapid growth made it irresistible to global auto makers, but the companies quickly realized that making cars locally was the best way to cater to Chinese tastes and budgets.

Peter Pang, the China president of German auto-parts and power-tools maker Robert Bosch GmbH, has seen a similar shift play out in his business. When the Stuttgart-based company came to China in the 1990s, high tariffs and government policies essentially forced it to use a local joint venture to get into the market. These days, Bosch has much more freedom to import its products if it needs to. But the Chinese market has become so much bigger and tougher, Mr. Pang says, that "you have to make locally simply because otherwise you won't be competitive."

That changing dynamic has raised questions about the future of market-opening reforms in China. The country's entry into the WTO on Dec. 11, 2001, started it on a path of gradually lifting tariffs and other trade and investment barriers. While China hasn't been released from its WTO obligations, it has come to the end of the changes it was specifically required to make under its terms of entry.

As a result, the search is on for ways to continue to engage China. Much of the U.S. cabinet will visit Beijing this week for the first meeting of a so-called strategic economic dialogue, a new series of high-level meetings to discuss the two countries' relationship. The European Union is planning a similar process.

"China is more open than at any time in its history," said Minister of Commerce Bo Xilai in a recent speech. But, he added, "The coming five years will be an even more important period for China's development."