



Book The China Price

The True Cost of Chinese Competitive Advantage

Alexandra Harney
Penguin, 2008

Recommendation

Shoppers know that the ubiquitous “Made in China” labels on everything from basic food and clothing to high-end electronics usually mean low prices. But most consumers don’t realize the full extent of the repercussions that the “China price” extracts from the Chinese and the rest of world. Journalist Alexandra Harney undertakes an in-depth investigation into what Chinese workers must endure to save the average American family \$500 a year: low wages, crushingly long work days and brutal – sometimes deadly – working conditions. But she also reveals the hidden costs the world pays for the China price, including climate change, air pollution, unemployment and unsafe products. Harney gained unprecedented access to secret factories, workers’ homes and government offices to hear the personal, often chilling stories of what China’s economic boom has meant for millions of people. Although Harney’s argument ignores some mitigating factors, such as China’s right to industrialize and the good that growth in China has achieved, *BooksInShort* strongly recommends reading this book before your next shopping trip: Reflect on what that “\$3 T-shirt or \$30 DVD” player really costs the world.

Take-Aways

- China’s massive, low-wage workforce made “the China price” possible.
- Multinational companies demand ever-lower prices, which lead to labor abuses.
- Migrants from China’s interior to its coastal manufacturing centers encounter low pay, long work shifts, substandard housing and little access to health care.
- To combat exploitation, multinational corporations maintain “codes of conduct” for their suppliers, but they can’t effectively govern suppliers’ compliance.
- China’s economy runs on coal, but the resultant pollution affects the entire planet.
- China’s one-child policy will reduce labor availability, which will lead to higher wages.
- The government discourages most labor activism, but recognizes the risk of social upheaval from aggrieved workers.
- An entire industry has emerged to aid companies in falsifying compliance with ethical labor standards. This helps Chinese factories stay competitive.
- Many firms consider their supplier codes of conduct little more than public relations mechanisms for managing their legal and reputational risks with Western consumers.
- The China price is climbing; China now faces competition from even cheaper countries.

Summary

At What Cost?

China now is the world’s third-largest manufacturer of all types of products, from low-end consumer goods to high-end electronic equipment, and it is poised to usurp the United States for the top spot by 2020. What China makes, it sells abroad: Its exports rocketed from \$26 billion in 1984 to \$1,218 billion in 2007. Walmart “buys at least \$18 billion worth of goods from China every year.” Samsung, IBM, General Motors and numerous other multinationals buy extensively from China. The tremendous low cost of Chinese-produced merchandise – “the China price” – has catapulted the country to new economic heights.

“‘The China price,’ screamed a BusinessWeek headline in 2004, has become ‘the scariest three words in US industry’.”

The China price derives largely from the country’s huge, low-cost working population. Some 104 million laborers work in China’s manufacturing and assembling

industries – the equivalent of all the manufacturing employees in the US, the UK, Canada, Japan, France, Germany and Italy combined, times two. Most of China's laborers are migrants from the poor rural interior, who relocate to manufacturing centers for work, often living in crowded, squalid dormitories. Their average pay – \$0.57 per hour in 2002 – is lower than the average wage that an Industrial Revolution-era worker earned in the UK in the 1800s. China's cheap labor is why 2.3 million work opportunities vanished from the US between 2001 and 2007.

“Over the last several years, the China price has redrawn the global manufacturing map and laid the foundation for the next economic superpower.”

The China price translates into an average annual savings of \$500 for the typical American family. But these savings extract a significant cost not only from exploited Chinese laborers and unemployed US workers but also from the rest of the world. In 2007, tainted Chinese pet food killed not only cats and dogs, but also poultry and hogs, which posed a risk of contaminating the US food chain. Later that year, 100 people died when Chinese manufacturers mislabeled a deadly chemical that ended up in cough syrup in Panama. In separate incidents, the US recalled Chinese-made toys containing lead paint and warned against potentially unsafe Chinese automobile tires. The environment suffers, too: Air pollution from China travels as far as Oregon and Washington State and affects weather patterns along North America's west coast.

“China has become legendary for its ability to undercut prices for everything from consumer goods to industrial machinery. The only way for manufacturers elsewhere to compete was to move to China themselves.”

As the Chinese juggernaut rolls over other nations' industries, China stands accused of dumping, of keeping its currency undervalued and of contributing to global climate change. But China's advantages – low-wage workers, cheap land, government inducements, political stability, and solid transportation and communications infrastructures – continue to draw global business.

The Economic Cost

“China emerged from three decades of relative isolation in 1978.” Since then, the government has relaxed restrictions on farming, currency and industry, propelling China economically. “Clusters” of specialized businesses have grouped together within cities, which have “emerged as leading manufacturers of specific products.” More than 1,000 of these industrial clusters exist along China's “coastal export region.” For example, one 40,000-worker factory in the town of Shunde makes almost 50% of the world's microwave ovens; 1,000 specialized companies located in Shengzhou produce 40% of the world's neckties; and the city of Dongguan assembles so many computers that “if there is a traffic jam between Dongguan and Hong Kong, 70% of the world's computer market will be affected.”

“The high costs the country pays to achieve the China price make sustaining it a high-wire act.”

These specialized centers make manufacturing faster and more efficient, allowing these industries to compete ferociously for Western customers, who are corporate giants that demand razor-sharp pricing for their bargain-hunting consumers. This strenuous competition means employees commonly put in 12- to 18-hour shifts, seven days a week. Wages are poor and often withheld, and children work alongside adults. Chinese law prohibits these abuses, but enforcement is minimal, so factory managers who do obey the regulations lose out on a comparative advantage.

“Coal, more than any other product, lies at the heart of the China price.”

When these abuses first came to light in the Western media, companies like Walmart established a “code of conduct” for their suppliers and dispatched auditors to conduct site visits to ensure compliance. The terms of these codes and audits vary among corporations, which charge the Chinese factories fees for their inspections. To avoid having to institute differing, expensive and burdensome rules, Chinese business owners create “shadow,” or unregistered, factories in other locations that mirror the “five-star” factories their Western suppliers audit. The shadow factories run longer shifts and pay lower wages, but desperate migrants from the countryside snap up jobs in these places. The shadow factories allow Chinese business owners to meet their corporate customers' stringent demands for high production at low costs.

The Health Cost

China's booming economy also has consequences that harm people's health: “More than 200 million Chinese workers in 16 million companies are exposed to dangerous working conditions.” Some towns and provinces that specialize in industries like mining are known as “cancer villages” or “widow towns” because of the high incidence of deaths from lung diseases such as silicosis, a preventable illness caused by poor ventilation and inadequate safety equipment. Migrant workers don't have health insurance, and their deplorable living conditions spread disease. In these towns, babies often are born with deformities.

“In a world where so many are cheating to keep costs down, telling the truth becomes a handicap.”

While China has tough laws on worker safety, it lacks trained inspectors. Recently, litigation and court judgments in workers' favor have prompted more people to address their grievances through formal processes. The Beijing government recognizes that aroused masses could threaten the country's political and social stability, so it is mandating greater access to health insurance for workers. Still, one Chinese health official sums up a popular sentiment: “The multinationals...brought dangerous work and pollution and left with the profits.”

The Environmental Cost

Coal supplies more than 60% of China's energy, and the country produces and consumes more coal than any other country in the world. China's economy runs on coal, which presents massive pollution problems. Due to its dependence on cheap coal, China spews more carbon dioxide and sulfur dioxide into the atmosphere than any other nation, thus contributing to global climate change. Other side effects of China's reliance on coal include acid rain, smog and mercury poisoning. Air pollution in some cities affects children as badly as would smoking “two packs of cigarettes a day.” In 1998, a United Nations agency said the city of Taiyuan in coal-producing Shanxi province had the dirtiest air in the world. Moreover, only 20% of China's 27 biggest cities meet minimum government standards for drinking water.

“The pressure on price can pit a company's compliance department against its buying department.”

But more industrialization calls for more coal. One-third of the nation's coal comes from China's 16,000 coal mines, 90% of which are perilous, small, privately owned enterprises. Many poor people eke out a subsistence living extracting coal by hand without safety equipment or proper ventilation. Some private coal mine owners do well enough that they comprise a third of China's millionaires, but most others, attracted to the rising prices for coal to meet growing demand, operate small, illegal mines. Alternative energy sources – even the celebrated Three Gorges Dam – can supply only a fraction of current energy needs. That means pollution will continue for the time being. Future clean-up operations will cost the coal industry money, raising the price of energy, adversely affecting China's competitiveness and raising the China price.

The Social Cost

The inequities brought on by China's economic miracle are making Chinese workers politically and socially aware. Today's migrants benefit from the factory experiences of their older family members and friends. This "second wave of post-reform migrant workers" is less tolerant of poor working conditions and is more likely to take legal action against abuse. This faction of the workforce is the product of China's one-child policy, which augurs a dwindling supply of labor in the near future. Greater dissemination of information also means that migrants, who largely are undocumented and uninsured in the cities where they work, are beginning to agitate for greater rights. No longer content with earning just enough money to support themselves or their families back home, they aspire to long-term, productive careers and social acceptance. They are less likely to return home and, thus, they present greater burdens on the resources of larger cities.

"You've got the absolutely perverse system where everyone is incentivized to cover up the problems."

Informed workers and lawyers are establishing nongovernmental organizations to present unified fronts against bureaucrats and corporate management. They are winning court cases for labor compensation and speaking up against injustice. With support from foreign labor organizations, independent unions are challenging the ubiquitous but largely ineffectual All-China Federation of Trade Unions (ACFTU), which is the only union that the Chinese Communist Party permits. While the government restricts most protests, it gingerly is testing some worker freedoms within the controlled confines of the ACFTU. Many younger people are looking for ways to safeguard their rights within the system, rather than seeking to foment revolution. But the China price depends on low wages and cost savings from inadequate employee protections and damaging energy use. These practices are under threat from shifting demographics that promise fewer – but higher-paid – workers to fuel the Chinese economic engine and to underwrite the China price.

The Corporate Cost

Multinational corporations that use China as their manufacturing and assembling center are responsible in many ways for the conditions they encounter. Their clout in negotiating with comparatively smaller manufacturers means they usually dictate terms, often contrary to their own policies. For instance, one Chinese factory owner turned down business from Timberland when the shoe company's deadlines would have forced the Chinese laborers to work longer than the maximum 60-hour weeks restriction that Timberland's own code of conduct put in place.

"A decade of monitoring by multinationals has not led to substantial improvement in working conditions in Chinese factories."

While some firms' core values promote social responsibility – like Levi Strauss, which was the first company to propose a supplier code of conduct – most firms consider their codes of conduct as mere public relations mechanisms to manage their legal and reputational risks with Western consumers. Disney, Target, Kohl's and Home Depot provide little useful public information on their suppliers, while Walmart, Reebok, Adidas, Nike and Gap are much more forthcoming. Yet even the largest multinationals can't patrol all their suppliers all the time, and even if they could, their own demands for the lowest possible prices and the fastest delivery times preclude most of their codes. For example, only 5.4% of Walmart's global suppliers pass its compliance tests. Any factory manager that could meet all Walmart's ethical standards would have to raise his prices to do so and probably would lose Walmart's business in the process.

"Our appetite for the \$30 DVD player and the \$3 T-shirt helps keep jewelry factories filled with dust, illegal mines open and 16-year-olds working past midnight. We all pay the China price."

In response, a new occupation has taken root in China: "Falsification engineers" consult with companies on how to doctor documents and conceal illegal overtime or faulty working conditions to meet client codes of conduct. Observers estimate that about 80% of Chinese factories flout compensation rules, and 95% ignore working-hour limits. So in essence, big corporations have taught their suppliers how to game the system, and multinationals know less now about the conditions within their suppliers' operations than they ever did, which raises the question: "What else are Chinese factories hiding?"

The Future Cost

Some Chinese firms and Western corporations are receptive to change. They're working to create "model" factories that provide adequate pay, benefits and working conditions. Yet "rising wages and material costs, greater demand for unionization, a higher risk of litigation" and "a dwindling supply of cheap workers" jeopardize China's competitive advantage. The China price is climbing: since 2004, export prices have risen 2% per year. Already lower-wage Vietnam, Bangladesh and India are luring multinationals to consider a "China-plus-one strategy," where firms conduct operations in China as well as another low-cost Asian base to stave off political and other risks.

"China makes you sharp or it kills you." (Eslie Sykes, manager of a Flextronics plant, Guadalajara, Mexico)

China cannot afford to continue competing in world markets based on price alone. It must move up the economic value chain, educate its citizens and assure good jobs for hundreds of millions of restless workers in order to achieve its own ideal: a "harmonious society."

About the Author

Alexandra Harney is a journalist who has covered Asia for *The Financial Times*.

