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China – Dancing With A Partner Or An Elephant?

As America focuses on rebuilding from two hurricanes, integrating two new Supreme Court Justices and trying to figure out what the heck the Federal Reserve Bank is going to do to interest rates, the rest of the world moves on. It is fascinating to note how China has recently emerged as a major player on the international free trade scene. Many people believe that China is attempting to position itself as a leader in global investment to counterbalance our economic influence as the world's lone remaining superpower.

We all realize that the price of gasoline has gone up, public debate may rage on as to the reasons and what to do about it, there can be no doubt that the economies of Southeast Asia are demanding more energy and they are not going to be content to idly sit by watching the U.S. and Gulf states control the world's supply of oil.

Oil is the most important factor for every country's economy. China is targeting two areas of the world so as to increase its influence at the expense of the United States. Surprisingly, the first and foremost of these is Australia. A recent defector from the Chinese diplomatic corps indicated to a U.S. Congressional Committee that China is hoping to drive a wedge between Australia and the United States. Beijing recently signed a contract to buy an Australian liquid natural gas manufacturer, in order to obtain natural resources Down under and to also increase its political influence there.

The new Chinese leader's name is Mr. Hu, and he came to power in 2003, at a reception of the Australian parliament, where he delivered a clear message that China is now ready to be an economic partner with that country. The iconoclastic Australian legislators gave him a standing ovation whereas the day before, President George W. Bush was derided in front of the same assembly when he delivered a speech focused on terrorism and the war in Iraq.

In addition to Australian natural resources, China has its eyes on nearby Central Asia. The Republic of Uzbekistan recently gave the U.S.A. the boot, giving notice that we need to leave their country and abandon the military bases we have built there as supply points for efforts in Afghanistan. In addition to being strategically important for military purposes, the Uzbekistan and Central Asian region is rich in oil and other natural resources. China recently signed several oil exploration deals with this country and Kazakhstan as part of its efforts to increase ready access to oil production.

The U.S. is responding to this competitive challenge by increasing protectionist measures and invoking more dogma. The recent political reaction against China's oil company's efforts to buy Unocal, which had only very minor assets in the United States, was telling. Because it is a United States based company, our Congress got involved and basically told China's state petroleum company to take a hike. When it is U.S. oil interests at stake, talk about free markets vanishes.

At the same time as they seek expansion opportunities, China's own economy is closed to foreigners for the most part because it doesn't allow for the free flow of information, money or people. The speed with which China works in foreign trade, relative to the U.S., is telling. China agreed to reduce import tariffs on agriculture from above 40% to below 10% between now and 2010. In the United States, special interest groups make it almost impossible for U.S. trade negotiators to offer similar concessions.

Closer to home, China has its eyes on Canada as well. It has entered discussions with Canadian resource owners about developing the huge oil rich sands of Western Canada. U.S. companies have for years refused to get in involved with these projects because of the large capital investment involved. Chinese state controlled conglomerates tend to have a very long-term view and they can afford to be so minded since they do not have to respond to shareholders' needs for short-term earnings in order to stack prices up or keep management bonuses intact.

China's demand for natural resources such as iron, copper, aluminum, natural gas has strained global prices. China is encouraging its domestic companies, which I believe are hand-in-hand partners with the government, to invest overseas with little regulation. About 135 countries are on a list that Chinese companies can invest in without any extra regulatory oversight. Notable among the names missing from this free trade list are the U.S., Japan and the United Kingdom.

The U.S. is losing influence in Asia relative to the Chinese. Last year, China encouraged the formation of a trading block in East Asia that excluded the United States from its membership. It did include Australia and New Zealand and the first of these events will take place in Malaysia around Christmas time.

When American's get past our national anxiety about mortgage rates, inflation, building supply costs and short-term investment returns, we might want to be thinking more about our long-term competitive position in the world markets, vis-à-vis players like China who is disciplined and has an ultra long range focus.

If you think that owning stock in U.S. multi-national corporations will allow us to take advantage of the growth in Chinese influence, think again. For example, one of the most profitable segments in the U.S. economy is the finance industry. Credit cards are among the most profitable of that industry's products. In China, banks such as Citigroup are hoping to take advantage of the increase in the Chinese retail consumer finance market. Here's why this may not happen.

China only has about 50 million people who make more than $5,000 a year. It is only these people who have enough extra income to buy consumer goods. About 30 million Chinese or 60% of those able to make any kind of discretionary purchases at all decided to travel overseas. There are only about 12 million credit cards in circulation in China, and this is expected to double twice over the next five years. This would seem to be a prime opportunity for U.S. and European corporations that have much experience in consumer finance.

The problem is that there are so many Western and other Asian companies vying for Chinese business that the profit margins have basically evaporated. Retailer credit information on Chinese consumers is practically non-existent and must be gathered on a personal, verbal basis. U.S. and European companies are spending a great deal of money to penetrate the market in China but many experts feel that what might have been good elsewhere is not necessarily going to work well in the Chinese market.

Foreign banks are prohibited from dealing with Chinese individuals until the end of next year. With the onset of the 2008 Olympic Games in Beijing, optimists are hoping that the Chinese will get hooked on credit cards, much like Americans have. As China expands its influence in economic ways, political power will surely follow. For this reason, investors may want to shy away from Taiwan and towards Australia. Putting money directly into China's stock market is a game for brave or foolish investors, but to ignore that region of the world in your stock portfolio is to settle for less than optimal performance.