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COMMENTARY

Lure of 'China Price' gets more expensive

In recent years the phrase "China Price" has scared American manufacturers, who are often pressured to match the low prices of Chinese imports. But now the China Price is rising. While the trend of outsourcing to China is unlikely to be reversed, it may well be slowed. Here's why:

VIEWPOINT
ANDREW BROD

• Rising Fuel Prices: The advent of containerized shipping lowered costs and made the modern global supply chain possible. Outsourcing to low-wage countries became a viable alternative. The result was a revolution in the way products are made and sourced. But the revolution got a big assist from fuel prices that fell steadily in real (i.e. inflation-adjusted) terms.

Things are different now. Oil prices have been trending upward since 2002 (up 90 percent in the last year alone!), thanks to stagnant supply and rising demand from emerging economies, especially in Brazil, Russia, India and China. Every dollar increase in the price of oil adds a de facto tariff that makes imports less attractive.

Not surprisingly, this has changed the equation of shipping containers from China. A new study by CIBC World Markets finds that the average cost of shipping a standard 40-foot container from China has nearly tripled since 2000.

Just as drivers are starting to adjust to higher gasoline prices, shippers are starting to alter supply chains. *The Wall Street Journal* recently reported anecdotal evidence that some manufacturing jobs are returning to North America due to higher fuel prices. The CIBC study finds that Chinese imports of products (like furniture) with low value-to-weight ratios (for which shipping costs make up a large proportion of total costs) are already declining.

• Rising Wages: China's rock-solid advantage since the start of its push for export-led economic growth has been its low wage rates, fueled by an apparently endless supply of rural laborers. But even China is finding that human capital is not inexhaustible, in part because of the country's restrictive "one child" policy and in part because economic growth is creating other opportunities for talented workers. Chinese manufacturing wages have risen by double-digit percentages since 2002, much faster than in the 1990s and even faster than the economy as a whole has been growing.

Chinese wages must be much lower than U.S. wages for outsourcing to work, due to elevated costs of quality control, managerial oversight and of course transportation. Consequently, while wages are still low in China, there is growing pressure on manufacturers to find even lower wages, whether in China's interior or in other countries.

• Other Developments: For years, China kept its currency cheap relative to the dollar in order to encourage exports to the U.S. In 2005, China changed its currency policy, and since then it has risen about 16 percent against the dollar. At the same time, the dollar has undergone an extensive devaluation against major currencies, including a nearly 40 percent drop against the euro since 2000.

The dollar's overall decline has hurt Chinese revenues, and it's connected to a number of rising material prices that Chinese manufacturers must pay (especially oil, which is traded in dollars).

Rising prices for other commodities, notably food and metals, are also pushing up the prices that Americans pay for products made in China. Overall, we're experiencing a kind of "perfect storm" of inflationary effects.

Will high fuel prices, rising wages in China, the weak dollar and rising commodity prices cause American manufacturing to rebound suddenly? It's unlikely. In many industries, the beneficiaries will be Mexico and Central America; in others, Vietnam and Malaysia. But with relatively low rates of manufacturing capacity utilization in the United States, there's room here to absorb some increased production.

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A dose of reality in this divisive incentives debate

A dispute has flared up in Charlotte/Mecklenburg County over the use of incentives that has a recruited company miffed and people at the Charlotte chamber hot as a firecracker.

In exchange for investing $3.2 million to build a plant in the county that would create 41 jobs with an average wage of $43,000, Germany-based Mias Inc. asked for a three-year grant that would reimburse $107,837 in city and county property taxes.

The Charlotte City Council approved the grant, with its portion being $38,121. But Mecklenburg so far has balked at going along with the deal for a simple reason: By their figures, the grant would cost more than Mias' investment would generate in terms of taxes. That's the conclusion reached by Bobbie Shields, the county's general manager (essentially an assistant county manager) who produces a fiscal-impact analysis that examines the costs and benefits of offering an incentive. That modus operandi is fairly common, but the Mecklenburg formula is more expansive than most used around the state.

GUEST COLUMN
DALE GIBSON

In the Triangle, Wake County Manager David Cooke tells me he uses a formula in which the assessed property value and resulting tax payments of any new facility is weighed against the cost of an incentive. If the incentive is more than the property generates in taxes, it would be rejected.

Here's how Mecklenburg figures its cost-benefits analysis when deciding on incentives, according to reporting in the *Charlotte Business Journal*, a sister publication: Shields says the county assumes that each new job that's created increases the total work force by one, thus requiring the location of a new resident into the market. That, in turn, increases the demands for education, public works, public safety, libraries and other government services.

As Mecklenburg County's Shields has it figured, a company must offer annual salaries of $60,000 or greater to not be a drain on county resources. In the case of Mias, the county's analysis determined that the company actually would cost the county $121,004 over six years. During the grant's three-year span, the county estimates it would lose $33,000 for each year by providing services.

Even after expiration of the three-year rebate, Mias' investment would net a negative of $11,000 for the county, Shields figures. Those numbers aren't sitting well with business advocates or the folks at Mias. "Mecklenburg County doesn't welcome us. This is the signal we got," Mias CFO Christian Borstler wrote in an e-mail to the *Charlotte Business Journal*.

The Charlotte chamber's Justin Hunt says of the cost-benefit analysis: "We have difficulty in understanding how that model works. This is a project that meets all of the guidelines under the program as published by the city and county. It meets every one of them in terms of jobs, wages and target industry."

Those who support the practice of granting incentives argue that the creation of jobs is the desired end result. They tend to sweep aside other considerations, but then, their paychecks are based on notching job gains into their pistols.

OK. Fine. We need jobs. But how can the granting of incentives be smart public policy when governments are slowly digging themselves into bankruptcy by agreeing to deals with negative returns.

Frankly, it's not.

DALE GIBSON *is managing editor of the Triangle Business Journal, a sister publication.*