

Are American and European Companies Returning Back from China?

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Abstract - China has been the destination country for many international companies investments. Economy keeps very competitive and many investments are coming yet to China, where production costs are low. Chinese economic power and its capability to penetrate in international markets made China a very consistent and affluent economic country. However, many companies are coming back from China because they consider that the reduced costs (principally wages) are not anymore as attractive as before. An analysis of this new international scenario is made in this paper as much as a perspective for the future and the implications for companies.

Keywords - China, USA, EU, Competitive Advantages, Development, Foreign Direct Investment.

1. Introduction

Considering that international investments are explained as the flow of investment capital into and out of a country by investors who want to maximize the return on their investments, it is necessary to have in mind that one of the major factors that influences international investment is the potential return on alternative investments in the home country or other foreign markets.

The present stage of globalization is characterized by a significant increase in Foreign Direct Investment (FDI). Some countries consider essential to promote development and economic growth. Multinational USA companies throughout the last decades have looked abroad for good opportunities for international investment. EU has considered FDI domestically essential to promote the stabilization of growth and employment, not discarding good opportunities to invest abroad. China has been the country that most has attracted FDI. A good combination of factors has given China the potential to become extremely competitive in this area.

Representing an important basis for productivity gains and playing a central role in establishing

businesses and jobs, FDI constitutes the essence of the global supply chains that compose the modern international economy.

In fact, the inter-dependence and the complementarity existing between trade and FDI are effective and significant. As early as 1996, World Trade Organization (WTO) showed the interlinkages between FDI and trade presenting a report on "Trade and Foreign Direct Investment" focusing on the economic, institutional and legal interlinkages between FDI and world trade. The report also examined the interaction of trade and FDI, including the impact of FDI on trade of home and host countries. This report reviewed the perceived costs and benefits of FDI, and analyzed the implications of competition for FDI among host countries. A review of the regulations governing foreign investment was also made, together with a brief discussion of existing investment, related WTO rules and disciplines and had a final conclusion considering the key policy issues facing WTO members (WTO 1996).

The increasing globalization of the world economy and the fragmentation of production processes have changed the economic landscape facing the nations, industries, and individual firms. Multinational corporations have been key agents in this transformation by creating international production and distribution networks spanning the globe and actively interacting with each other. The result has been the growth of intraindustry or increasingly intraproduct trade at the expense of traditional interindustry trade (Kaminski and Javorcik, 2005).

In section 2, a review of some important aspects of relative advantages of countries is made, studying competitive advantages and international investments. In section 3 some reasons are pointed out for the American companies' return from China. In section 4 an analysis of EU case is made. In section 5 the attractiveness factors of China are approached and finally, previous to the final notes, some perspectives for the future are presented.

2. Competitive Advantages and International Investments

The comparative advantage theory defends the capability of an entity (a person, an organization, a country) to produce a given good or service at a lower marginal and opportunity cost. In the situation in which a country is more efficient in the production of all goods than another one, both of them will still benefit by trading with each other, as long as they have different relative efficiencies. Comparative advantages were explained by Ricardo considering two countries, Portugal and England, and each one of them should specialize in one specific product in the bilateral trade (wine and cloth), the one in which has comparative advantage.

The option for a comparative advantage can lead a country to get specialized in exporting primary goods and raw materials, what may trap the country in low-wage economies due to the terms of trade.

The competitive advantages theory shows, by its side, that each person can become in a better situation if his choices are based on a competitive advantage at several levels, whichever they are at the national, the corporate, the local, or the individual levels. With this in mind, states and businesses should follow policies that allow them to produce high-quality goods to be sold at high prices in the market. Porter (1985) highlighted that growth of productivity should be the focus for national strategies. Cheap labor is ubiquitous and natural resources production may not be necessarily good for an economy.

Competitive advantage attempts to maximize scale economies in goods and services that get premium prices. To gain competitive advantages it is important to get the best performance. The long term survival of a company or the country competitiveness may depend on the gains it can obtain from getting competitive advantages in the global market.

Companies face rapid changes in the global market that directly influence their competitive advantages. The dynamics of competition and the eternal cycle of innovation and imitation are subjects to be considered in the global market. Competitive advantages may be quickly matched or exceeded by competitors. Companies should continually develop new products, organizational abilities and look externally to find out conditions to get competitive advantages for the company. If a company is merely reactive to the innovations or to the improvements on the market it may be unsuccessful on getting a competitive advantage. An active attitude is needed to create a framework favorable to the company in

the context of global competition. This global competition increasingly requires an incessant exploration of new ways to get value growth.

Companies' investments abroad need involving and multifaceted dimensions in the organization in order to promote competitive advantages and to get new competences to the company. These investments require that the company knows a lot about the risks and the general environment of the destination country. Political and macroeconomic conditions, infrastructure and human capital, domestic policies, bureaucratic environment, for example, are essential to get FDI. The political stability of a country's government works often in order to be determinant to get investments particularly from international companies. In fact, a company needs to know well the political expectations about a country and to get a dynamic strategy to be well succeeded in the international market. The complexity of this analysis requires the understanding of the way the interrelationships are made. In the last decades, China has obtained strong advantages to receive foreign investments, being the development of China the reflex of the success of China's economic policy and competitive position in the world global market. One way for a company to get successful was to go to China, where the company could produce at low cost the same products the company used to produce in the domestic market. This began to be done by some companies and rapidly the example was followed by others by installing plants in Chinese territory. This factor constitutes a way to get competitive advantages in the market.

Considering that companies need to obtain the best performance for the future they use the available resources to get this performance. Many world companies, in particular the USA and EU companies, found in China the appropriate place to invest. They could find in China the best country to produce in order to get their best results. China represented a strong basis of low cost work force and a domestic market growing fast. In China companies could also find an artificially low currency. And China authorities use it to encourage the foreign investment as well.

Recently, a combination of economic forces is fast eroding China's cost advantage as an export platform. Many USA companies are returning back to supply North America basing their production in several low cost states in USA. Europe also finds some other countries to produce many of its products.

Now, as there are fast growing wages in China and some factors are contributing to get better

conditions on production abroad, some companies are considering to install their production in other countries. Sometimes they return to the origin country, others they invest in other low cost production countries. Anyway, for supplying some kind of products and for supplying the region, China production may remain interesting.

In fact, investments in China and Asian countries will keep interesting once the internal demand in some countries of the region is growing. Movements of capital will prevail in the coming years. Some companies moving from China for other neighbor countries and sometimes to other countries far way do so depending on many factors. In fact, considering the destination country, many of these factors are related to the analysis the companies make concerning political and macroeconomic conditions, including political risks, internal conditions for production, infrastructures and human capital, domestic demand, law, etc.

If the country does not meet these factors, so domestic reforms are essential to attract FDI, contributing to significant changes, and ensuring that regulatory framework gets stable, transparent, non-discriminatory, i.e. long term competitive. It is what some EU countries are trying to get, as it is the example of Portugal. Some other countries in EU south territory are making efforts to implement such kind of politics.

3. Getting Investments Back to the USA?

The evaluation of the foreign country conditions for FDI is of vital importance to the international business. The analysis of a country's political environment is considered essential to the operation of a foreign company business. This political environment has to be analyzed by the company.

The development of China is making that foreign companies look abroad to find competitive advantages in production in other territories. USA companies consider to transfer some plants to other countries and even to return back to the USA, producing in interesting conditions.

In fact, there are several factors that contribute to a new position of USA companies in what international investments in China is concerned. In fact, considering the BCG report (Sirkin *et al*, 2011), there are several reasons to move from China to USA:

- Wage and benefit increases of 15 to 20 % per year at the average Chinese factory will

reduce the low cost advantage of China over the low cost labor of some states of USA (from 55% today to 39% in 2015) if it is adjusted for the higher productivity levels of USA workers. In reality, labor cost is a small part of a product's manufacturing cost. And so, the savings gained from outsourcing to China drop to single digits for many products.

- Considering the transportation costs that many products have and their duties, supply chain risks, industrial real estate, among other costs, these products shall have small gains obtained from Chinese production.
- Automation and other productivity improvements are expected not to be enough to keep cost's advantage of China.
- In China and other Asian countries the income rising will contribute for the demand increasing. The multinational companies will devote more of their capacity in China to supply domestic markets of the region. It is expected that many companies bring some of their production work back to the USA.
- Manufacturing of some products will move from China to nations with lower labor costs, as Vietnam, Indonesia or Mexico. Anyway, these countries continue to be limited once they do not have adequate infrastructures, skilled workers, scale, domestic supply networks and there are additionally political and intellectual property risks, low worker productivity, corruption, and the risk of personal safety.

This process of investments' return to USA is now beginning and the adjustment for a new situation is in a very early stage. The shift will happen depending on a set of factors and on the industry sector itself. While China will keep an interesting platform for production for many companies of Europe and Asia and even still remain interesting for many USA companies, the truth is that USA is becoming more and more attractive for the production of many goods to be sold in North America.

4. EU Politics in International Investment Area

EU-China trade has increased significantly in recent years. China is now the EU's second trading partner behind the USA and the EU's biggest source

of imports by far. The EU is also China's biggest trading partner.

EU is characterized by an open market policy what has been very important to China's export-led growth. The EU has also benefited from the growth of the Chinese market and the EU is committed in increasing trading relations with China. However the EU wants to ensure that China trades fairly, respects intellectual property rights and meets its World Trade Organization (WTO) obligations.

Considering the principles that rule EU and the frameworks in terms of foreign investment, EU follows an approach which is both ambitious and flexible (see European Commission, 2010). Its main principles are that:

- It focuses on long-term investment, i.e. establishment that generates stable employment and growth;
- It improves market access and provides that foreign investments both at pre- and post-establishment stages are treated like domestic ones;
- It fosters transparency by clarifying the regulatory framework;
- It ensures that host and home states fully retain their right to regulate the domestic sectors;
- It aims at freeing the flow of payments and investment-related capital movements, while preserving the possibility to take safeguard measures in exceptional circumstances; and
- It seeks to facilitate the movement of investment-related natural persons ("key personnel").

The Lisbon Treaty amends the Treaty Establishing the European Communities, and renames it the Treaty on the Functioning of the European Union (TFEU). Article 207(1) of the TFEU explicitly mentions foreign direct investment as forming part of the common commercial policy. As such, the Treaty establishes the EU's exclusive competence on foreign direct investment. As a result, the EU investment platform vis-à-vis third countries could be gradually enriched with investment protection standards for all EU investors establishing its presence in these countries.

5. China strength

After the confirmation of China as the strongest competitive country in the beginning of this century, USA have maybe felt the greatest challenge to their position on the competitiveness ranking. The big question about the future world economic leader is now taking place.

China got an apparent unbeatable combination of factors to get the hegemony of world economy. Cheap work force, a rising pool of qualified technicians in several areas, particularly in engineering area, for example, a undervalued currency, a politic of cheap land and free infrastructures, and a politic of significant financial incentives, all together made China a very fast growing competitor in the market, making China the first world player in international trade and an important political and geostrategic player in many scenarios. Indeed, China got the world's second largest economy and the biggest exporter in the global economy, but also an increasingly important political power. After entering WTO in 2001, China has become the default option for companies that wanted to outsource production at low cost, as a consequence of the very coherent and consistent management of the economy, planned and visionary, including the management of natural resources and the development management in general. This vision has contributed to guarantee the future development of China, and its economic and politic power.

What about now? Is it credible that the emergence of China is synonymous of USA and Europe decline? It seems that USA may continue to keep an important role in the international arena. The economy keeps robust and the flexible structures may continue to give to the economy some of the strengths it needs to overcome this phase.

EU is now trying to overcome a very severe internal crisis. The economic strength of EU is now sustained but the future requires that many adjustments have to be done. Some countries are implementing strong programs of internal economic reorganization.

China has assumed a place that it will keep for many years although the forces in the international stage are changing quickly. The question is not to know what China will be in the future but if the traditionally considered the most developed countries may keep their strength in the new reality. USA, with strong basis and flexible factors, may guarantee a new breath to the new "war". About Europe, new and hard changes have to be done. Political will seems to exist but implementations are always delayed. A

much more rigid system exists in Europe compared with United States.

Considering the new combination of factors in China about new wages, the rising transport costs, the new price for Chinese coastal lands where a significant part of production has been headed, USA may profit from using the internal adjustments to come back to a new positioning, bringing some production back to USA territory. In EU investments are being redefined. However, many companies will keep in China with their production based particularly for supplying the region; and sometimes they will move for neighbor countries with lower production costs. In short, China will not be weakened because China production and economic potential is expected to be kept.

6. What About Future?

Despite the USA potential rise and the internal reorganization in EU, the China's potential will remain very strong. Manufacturing power of China will be maintained. China has a very large domestic market and this Asia region is very strong in the context of the world economic order. In the last years, China has converted all the potential to adjust the productive structures and has enlarged the base of their production to many capital-intensive industries, has guaranteed many skilled and talent work force and has developed many micro infrastructures and super structures to guarantee conditions for the Chinese development (at macro and micro levels). Many coastal cities in China are now very well positioned for new challenges. China has also guaranteed abroad the employment of their work force in excess at very competitive conditions, penetrating all over the world and guarantying an interesting positioning for the future. A positioning in terms of natural resources has already been got. China continues to be a strong low cost exporter to Western Europe and facing the difference in cost production for the next years it is expected that will remain to be.

Anyway, there are significant changes in the China terms of trade and trade trends with the Western Developed Countries. The reality is changing fast. The shifting cost structure between China and these countries reveals more choices for companies' production in the future.

Many high labor products and products to be supplied to Asian countries may remain to be produced in China; it makes sense also to keep production in China for many products due to the

high technology incorporation and/or economies of scale.

Companies have now to decide about their global supply networks taking into account the usual criteria of total cost of production, the proximity of markets and raw materials, and so on, but at this moment the companies' analysis must include the new circumstances of fast change on the global combination of factors. Companies must make this analysis product by product considering particularly factors as worker productivity, transit costs, time to market considerations, logistical risks, energy costs, among other factors. An essential factor nowadays is the flexibility and dynamism of the supply chains, as their capability to be balanced. The flexibility to move from a center of production to another place is also crucial as much as to become closer to the final customer, according the needs of new demands. The relative position of countries determines a new stage for international trade, considering the rapid effects of international investment movements and the new requirements for production and supply and to respond to the new trends of demands.

In the long term, scenarios may be built; anyway predictions are not easy to be presented. The fundamentals exist but suggesting trends is a risky task. And that will be driven to another work, in which a reflection on this may be done. For now, just the idea that internal market of China will be reinforced in the future; and with this the economic power of China will be guaranteed. The capacity of China to supply many sophisticated products in the region (and even far away) is installed and the protection and control of important sources of natural resources have been also strategically planned.

USA have had along the last decades several periods of adjustment resulting from the economic international order. The flexibility that USA gave to the economy has permitted that adjustments could be made. Nowadays, one of the most powerful challenges for USA is out there. It is now the time to make a new wave of restructuration. Some kinds of reorganization of structures are in course and some of them have been already made. It is the example of General Motors (GM). A company like GM shows how rapidly reorganizations can be got. In two or three years GM got a profound internal reorganization, passing from insolvency to considerable profits and efficient levels of production. Its production and market position had to be profoundly changed. The case of General Motors shows in fact the possible recover of USA to be kept in the front line. In two years, after it nearly collapsed

into financial ruin, it is reporting record nominal profits for 2011 despite losses in South America and Europe. The record gains were driven by the strong recovery in demand for vehicles in North America. It still has not got all the way back to the "normal" status, so GM probably still has a way to climb. Anyway, GM is a vastly different company than it was before. It is smaller and has less debt, in consequence of the government rescue and bankruptcy protection in 2009 to cut its bloated costs. The restructured company was able to make record profit last year, even though U.S. auto sales were near historic lows at 12.8 million cars and trucks.

Examples like this one show that USA gets quickly new positions, as a result of big flexibility and internal dynamism. But the "war" is not won yet. The search for better methods and better general organization as much as improvements in logistic, labour efficiency and productivity combined to capital requirements may be the passage for a new phase of economic stability in the future if the results get achieved. If USA effectively get that stage, how long this economic shape remains? Will USA remain the last guarantee for the world balance in terms of geostrategic forces, whatever they are considering the countries or the regions?

EU defends the virtuosity of international trade and keeps trade policy as being essential to create growth and jobs by increasing the opportunities for trade and investment with the rest of the world. Internally, looks to define competitive conditions for domestic companies, looking at EU as a space for innovation and high technology industries. EU looks to the future creating new windows and factors of competitiveness, for instance by making adjustments in the production structures and creating more competitive macro frameworks for investments and production.

7. Concluding Remarks

It is not expected that China loses its leading position in the international trade, and especially it is not expected that China loses its economic potential in the region. Its fundamentals are very strong and solid and they guarantee a new position of China in what advanced technologies is concerned.

However, some USA companies will move back to the USA to supply many products in North American markets. Many plants will be transferred as well for other countries with lower costs of production. EU companies will try to reinforce the gains with commercial relationship with China. Anyway, European companies will work on a

competitive basis and will move as far as new conditions seem more attractive. EU will provide interesting conditions to get foreign investment in the European countries. China is looking as well to these opportunities.

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