

## **China and the WTO: *Interview with Mauro Guillen*** ***(edited transcript)***

**Knowledge@Wharton:** China has just completed 10 years of World Trade Organization (WTO) membership. In the decade that has gone by, the country has become an export powerhouse. Back in 2001, China's share in global exports was just 4%, but now it has become the world's top exporter with a share of 10%. How did this come about, and how has Chinese business been transformed as a result of this change?

**Mauro Guillen:** The reasons for this change are straightforward. As part of WTO membership, China got access to big global markets -- including the U.S. and Europe. This was in exchange for reducing its own trade protectionism in the Chinese market, which hasn't always happened but it has happened to a very large extent. That's the main driver.

The other important driver is that Chinese companies have become very competitive over the last 10 years. They already were in the 1990s, but now they have entered new industries. They have invested in their capital equipment and created new distribution channels. We already see the first Chinese multinationals, like Lenovo or Haier, making progress in global markets. In fact, Haier has become the largest household appliances company in the world. Those are the reasons why WTO membership has made China the world's largest exporting nation. The consequences are massive for the global economy as a whole and for the receiving markets -- meaning the U.S. and Europe -- and also for China.

**Knowledge@Wharton:** That is an interesting point about the emergence of Chinese multinationals. Haier and Lenovo have become global players. Do you see a difference between the way these Chinese multinationals have emerged and previous generations of Asian multinationals from Japan and Korea? Is there a difference in the growth and globalization strategies of the Chinese multinationals and those of other Asian multinationals?

**Guillen:** It's a very complex question. There are some common patterns. The Japanese and South Korean -- and now Chinese -- companies had one advantage going their way, which was they had a protected domestic market while they were still learning how to compete. So, for many years, Chinese firms had a captive domestic market and they learned how to make things they could see. Then they started to pursue foreign opportunities.

This was the case for Haier. Haier grew first in the domestic market and then it started to pursue foreign markets -- first, by selling products to Wal-Mart or to other American brands. So, they would make the washing machines for them. Then they started to launch their own brands. That's the common pattern. That also happened to the Japanese firms in the 1950s and 1960s, and the same thing was true of the Korean firms in the 1970s and 1980s. The big difference with China is ownership. Many of these firms in China have, at some point, at least, been state-owned. That wasn't the case of the Japanese firms or most of the Korean firms.

**Knowledge@Wharton:** What lessons can aspiring multinationals from Brazil or India learn from China's experience?

**Guillen:** I think multinationals in the U.S. and Europe can also learn from China. One of the biggest lessons is the importance of scale. Haier, Lenovo, BYD [which is one of the largest makers of rechargeable batteries in the world] and five or 10 other Chinese multinationals are making great inroads into the global economy. The big lesson, I think, is scale. The other big lesson is learning the ropes -- don't try to accomplish everything at once. First, study the domestic market, and then sell your products to somebody else to put their brand name on them in Europe and the U.S. markets. That is the way you reach scale and establish relationships. Once you're ready, you launch your own brand and try to conquer markets with your own resources and reputation.

It's a hard thing to do, obviously, because you're facing stiff competition by established players from Japan, from Europe, from the United States. But at least 20 or 30 multinational firms from China, so far, have made it. Ten years from now, there will be 100 or 150.

**Knowledge@Wharton:** What will be the implications for the incumbents in those fields?

**Guillen:** They're going to have to wake up. Many of them will be acquired by Chinese firms or they will have to sell some of their divisions to Chinese firms. Lenovo became a big global player after acquiring its PC business from IBM. Haier has also made some acquisitions. So the incumbent firms need to wake up. They need to realize that China is no longer just a low-cost manufacturing site. China is a big economy, a big domestic market. But it's also the home base for many firms that are becoming increasingly more technologically sophisticated. And they're also learning how to market, how to sell their products. The world of competition is changing quickly in large measure because the Chinese firms, the Indian firms, the Mexican firms, the Brazilian firms are getting out of their domestic markets.

**Knowledge@Wharton:** If you were to identify the industries in which companies are likely to be acquired by Chinese multinationals, which would you consider to be the prime targets?

**Guillen:** The number one category will be commodified industries. Chinese companies as well as Brazilian and Indian firms will have an interest in buying such companies and divisions of companies. Why? Because they like scale and they know how to operate on larger scales. Since margins are very low in a commodity industry, whoever is bigger wins.

This has happened in personal computers, which are a commodity. This has started to happen in many categories of electronics, which have also become commodities. This is going to happen also in the lower segments of the automobile industry, which are also very low-margin, very commoditized. A little later, we will start seeing this in high tech fields such as aircraft, biotech, possibly even pharmaceuticals -- we will see more activity. This will not necessarily be only in the form of acquisitions but also as alliances.

**Knowledge@Wharton:** During the past decade that China has been in the WTO, which areas have seen the most growth and success and which areas have been relative losers within the Chinese economy?

**Guillen:** Clearly, the manufacturing the assembling of goods has been a major engine of growth in China. Chinese companies and manufacturing facilities, regardless of ownership, have become very sophisticated. They know how to set up a plant, how to run it efficiently, how to turn out very high quality products. That's a major area in which the Chinese economy has clearly succeeded.

They've also become very good at building infrastructure. They're doing this obviously in China but they're also doing it increasingly in Latin America and Africa and other places around the world. Heavy industry has been another winner -- steel, cement, all the things that are required for building infrastructure or building factories. That's another part of the Chinese economy that has made a lot of progress.

The two areas where Chinese firms are still lagging behind are consumer products and financial services. If they don't address that problem, I think it's going to be a bottleneck. Because I know of no advanced economy in the world that has a backward financial system. You need a financial system that is sophisticated if you want to be a rich country.

**Knowledge@Wharton:** What do you see as the biggest risks of China's financial system as the country seeks to grow and overtake the U.S. as the world's largest economy in the next few years?

**Guillen:** The risks are two-fold. One is the large amounts of bad loans that some parts of the banking system in China have accumulated over the last 30 years. It's been a time of boom in China, but that doesn't mean everybody has that wealth. It doesn't mean that all the people who borrowed money are now in a position to return all that money. So, there's that problem.

The second problem is the nitty gritty, day-to-day operational details about how you run a bank, a bank that takes deposits and then extends loans to families and to businesses and does other types of commercial activity. Here what you see very clearly is that Chinese banks just don't have the experience, they don't have the sophistication. They don't have the management systems, the information systems, the marketing systems, the risk assessment systems in place in order to be profitable and be sustainable. They are working very hard to develop those systems, but it takes a while. China didn't have any banks, other than state-owned banks, up until 20 years ago. China's transformation has been so quick that the financial sector has not been able to stay on top of all of the developments.

**Knowledge@Wharton:** Do you see any political risks over the next decade?

**Guillen:** China is a country that faces many challenges. It's right now an economy that keeps on growing but they face issues such as air pollution and water pollution. They face problems with desertification.

China also faces problems with its neighbors. China's huge disadvantage is being surrounded by more than 15 countries, and not one of them historically has been a friend of China. Consider Korea, Japan, Russia, India, the Central Asian Republics, Vietnam, Cambodia and so on and so forth. All these countries have a territorial dispute with China. Every one of them. Either it's a land border or they're fighting over some islands. So China is a resurgent country, but in terms of geopolitical risk, it is in a tough neighborhood. It's a complicated issue.

**Knowledge@Wharton:** What does China's emergence mean for the rest of the global economy and the global governance system?

**Guillen:** The implications are huge. The best way to assess that is by looking at the numbers. China has a huge trade surplus with the rest of the world. In 2010, they accumulated reserves of about \$450 billion dollars. That's more than one billion dollars a day of reserve accumulation. Now, at the same time, that means that some of the other countries in the world are running deficits. Because if we don't have any trade between planet Earth and Mars or Venus, then if somebody's running a surplus like China, there's got to be somebody in the world who's running a deficit. And that's the U.S., that's some European countries and so on and so forth. This gives China financial clout. It also gives it power because China uses those reserves to help countries that have deficits make it through they year. They buy U.S. government securities. Now, the Europeans are trying to persuade China to buy European government bonds. So, this gives China clout.

The problem is that 20 or 30 years ago, China did not have this financial strength, so it is under-represented in all the important institutions in the world. The IMF is one of them, and so are all the development banks in the world. China has a lot of resources. They could have more voting power, they could have more voice. But they don't yet have it. We need to reform these international institutions now that China has become such a big power.

All the problems right now in the global economy catch us at a time in which we haven't yet made that change. The governance structures in place are still those from 20 years ago. But the problems are entirely new. We have all of these economies -- China, India, Brazil and Russia -- which were not very important from a financial point of view in the past, but now they are. We have no way of using them as a source of funds and as a source of support to overcome the problems that we're facing now in the global economy.

**Knowledge@Wharton:** Let's take one of those multilateral institutions, which is the one we began with, the WTO. During the past decade, there have been a number of trade disputes involving China. How do you expect this to play out over the next 10 years?

**Guillen:** The U.S. and Europe are also taken to task sometimes for subsidizing certain companies or certain products and protecting others and so on. But China as a developing country has more of these mechanisms of protection in place, so, naturally, they get more attention. Then there's also the problem with the valuation of the currency. Whenever China has been taken to court, so to speak -- when they're accused of doing something at the WTO -- they've been pretty good at trying to address the problem. Most of the time, the Chinese have accepted that they had violated some part of the agreement.

Let's remember that China is a developing country and it is categorized at the WTO as a developing country. This means it's easier to accuse it of all these transgressions. One of the things that China was mentioning a month ago when the Europeans were trying to get the Chinese to buy some government bonds was, "We'll buy the bonds, but in exchange for that, we want you to make us a developed market economy at the WTO." If that happens, that means it's going to be much harder to accuse China and to make it change its ways.

A lot of things are at play here. Seemingly, the Chinese want to play a constructive role in the global economy. They don't want to destroy the global economy because that would be devastating for them. They want the world economy to grow. They want Europe and the United States to be in a position that they can buy all these Chinese-made goods. But at the same time, they're asserting themselves and they want to be more influential. They want to be participants in the big decisions.

**Knowledge@Wharton:** In the face of Chinese assertiveness, do you see protectionism becoming a big risk in the future?

**Guillen:** China doesn't need to protect its industries because they're very competitive. As far as the rest of the world goes, certainly there could be temptations. Keep in mind that among developing countries and certainly among the BRICS, China is not the most protectionist country. Both Brazil and India are way more protectionist than China both in goods and in services. In India, as you might remember, there was this big uproar just a couple of weeks ago about Wal-Mart being able to operate there more freely than in the past. China is not the worst offender. Not only in other emerging economies, but also in Europe and the United States, there could be temptations. That would be a very bad outcome. In the short run, that would protect some workers or some companies in Europe or the United States or in Brazil. But in 10 or 20 years down the road, we would regret having protected those industries.

**Knowledge@Wharton:** You referred to the valuation of the Chinese currency. Do you believe that over the next 10 years, the Chinese RMB could become as influential a currency as the U.S. dollar or the Euro?

**Guillen:** No, I don't think that's going to happen and I'll give you the reasons. First of all, let's say if the Chinese currency is undervalued by 10%, that's the same as imposing a 10% tariff on imported goods or giving a 10% subsidy to Chinese exporters. The effects are exactly the same and of the same magnitude. This is highly distortive. I think the controversy right now is we know the renminbi or the yuan is undervalued; the problem is by how much. China has been letting the RMB gain in value over the last three or four years and that's a good sign. China, at the same time, still controls the currency. It's nonconvertible, which is to say, you cannot go to the market and buy RMBs.

The reason for that is very simple, which is that neither the Chinese economy nor the banking sector are ready to have a convertible currency. Chinese banks would just collapse if the RMB were made convertible, which means that you have to liberalize capital flows and you have to do a number of things. That's not something that's going to happen in the next five years or even 10 years.

China is doing swap agreements with certain countries around the world so that when they export or when they import from those countries, they don't have to use the dollar or the Euro as the currency. They can go directly from RMBs to the local currency in those countries. So, this is happening with some countries in Asia, in Latin America and in Africa. But it's still very small. The time when the RMB could play a major role as a global currency is at least 15 to 20 years away. Something very dramatic would have to happen in the Chinese financial system and banking sector for that to happen earlier.

**Knowledge@Wharton:** What advice would you give CEOs around the world about how they should navigate the future, especially as it concerns China?

**Guillen:** Well, you need to read as much as you can about China. The power transitions, such as the one that will be happening in the next few months in China, are going to be very important. We have to pay attention to that.



Moreover, it is very important to see what happens with the one billion people in China who are still relatively poor. Economic development and wealth have only reached the top 300 million. That's a huge accomplishment, but it's only about one-fourth of the entire country from the point of view of population.

I think you've got to watch the environmental issue in China very carefully. It is also important to keep an eye on the role China will play at the IMF, the WTO, and all the international development banks.

The best piece of advice is to keep an eye on what the Chinese are doing. Read not only the analysis that the American journalists or scholars or consultants are producing about China but also what the Chinese themselves are writing. Many of the reports of Chinese think tanks are now translated into English. It is important to understand that perspective -- how the Chinese are thinking about their rights as a major economic power in the world.