

Fast Facts

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WHY CHINA WILL EVENTUALLY IMplode AND MAY TAKE US DOWN WHEN THEY DO.

Some Background

The People's Republic of China (PRC) is an autocratic Chinese state ruling a land more than one third of which is inhabited by non-Chinese people. It is home to a fifth of the world's people. It is more than 4x the populace of the USA. It borders no less than 14 other nations, to the north, west and south. Its land borders alone extend 22,000 kilometers. It has a coastline of another 18,000 kilometers. China has twenty close neighbors, fourteen contiguous and six separated by slim stretches of sea. In size, language and culture, China is a rough equivalent to the whole of Europe. Plus, it has no one common language.

Who is Chinese and just what is China?

If you ask the people of Hong Kong, Taiwan, Tibet, Xianjiang and Inner Mongolia if they are "Chinese" and part of China they would, for the most part, answer "no." Xianjiang, for instance, takes up one sixth of the PRC map. It borders eight nations and is larger than all of Britain, France, Spain and Italy. It is rich in oil, tin, mercury, copper, iron, uranium, lead and cotton. Most of the Turkic people in Xianjiang are Uighur in nationality and Moslem in religion. Yet, in spite of having their own language, their towns and streets all have Chinese names, unreadable for most Uighurs. Part of the PRC's way of uniting all of China. Then there is Tibet, even more populated than Xinjiang with ties to the Dalai Lama. Yet, if one goes to the Tibetan Relics Exhibition in the Forbidden City, the captions were in Chinese and English, not Tibetan. Another attempt by the PRC to achieve unity.

China, even as it appears to change, is still China

China is ruled by an imperial-Leninist dictatorship. Leninism is about the centralization of power in the hands of a self appointed elite. It allows no fundamental political dissent.

As a Leninist dictatorship, it has goals:

One of its first and foremost goals is and always has been to continue to control its people. As the "new" China it must realize economic development, maintain its borders, and keep Xianjiang, Tibet and Taiwan in check. It also wants to be seen as an equal to the United States and it wants the world to believe that it needs them far more than they need it. They want to replace the US as the Super Power in Asia. As part of this overall plan, they are already planning their first manned space flight into outer space and are amassing a powerful military. But, are they truly capable of accomplishing all of these goals? They are if we continue helping them to supplant us, yes!

Just in case you missed it, China now deals with every country in the world. They belong to 451 international governmental organizations and 2,986 international non-governmental organizations, has a military capable of destroying nations across oceans, and has joined UN peacekeeping operations in Cambodia, East Timor, Mozambique, Iraq-Kuwait, Western Sahara, Liberia and Sierra Leone. They even received help from us with their problems in Xianjinag. Do you think they jumped on President Bush's anti-terrorism bandwagon because they felt

it was a good thing to do? NO! They did so, because they could now get help in trying to keep Xianjiang in line with the PRC. Xianjiang is heavy Muslem and had direct ties to the Al Qaeda and Bin Laden.

How the US contributed to its own supplanting

In June of 1998, President Clinton sent an entourage of some 1200 people, including 500 support staff and 200 reporters to China. As part of that trip he promised China to not stop in Japan. He was completely manipulated by China for their purposes. None or very little of what he said was ever heard by the Chinese people. Then, in a press conference in Hong Kong, he said, "What I would like to see is the present government, headed by this president and this premiere, who are clearly committed to reform, ride the wave of change and take China fully into the 21st Century." Was he stupid or just plain gullible? Neither, "this president and this premiere" were ever elected by the Chinese people. In a New York Times editorial it was stated that "Jiang used his appearances with Mr. Clinton to present himself as a statesman who could meet on equal terms with the leader of the world's richest and most powerful country." David Sanger of the same paper wrote, "They wanted the imagery of Air Force One flying right past Japan."

How gullible are we?

For some reason, we are of the opinion that China eventually will become capitalistic and democratic -- which is exactly what China wants us to believe. And why shouldn't they? Since it all began China's trade surplus with America rose from \$6 billion to \$100 billion. However, when it comes to the rest of Asia, China buys more goods than it sells in its trade with Asian nations. According to Michael Kurtz, Asian strategist for Bear Stearns, South Korea's trade with China has moved steadily upward from about \$500 million to \$800 million per month over the last 18 months. According to China, its imports rose a whopping 44.5% during the first half of this year, to \$186 billion. Earlier this year, China topped the US as the largest exporter of goods to Japan. Yet, Japan's exports to China are also soaring, mainly because its capital equipment industries are well positioned to China's needs.

According to a September 2003 article in World Trade Magazine, "the increasing consumption within China and other Asian countries will be a boon for American companies, as the region will grow into not only a source for manufactured goods, but also a market for them -- and for services. China has already become the second largest market in the world for major automobile companies such as VW, as well as for mobile phone firms like Motorola and Nokia, while Thailand is developing into one of the world's leading markets for Mercedes and South Korea has become one of the strongest markets for broadband Internet products in the world."

There is little, if any doubt that US multi-national companies are determined to make China a world force in everything from computers to cars. For example, companies like Ford, GM and Daimler Chrysler are putting the squeeze on parts suppliers to build factories in China. (You know that new Chevy Equinox SUV you were looking at? The engine will be made in China.) Back in July, Ford announced it will buy \$1 billion in parts from China in the next year with hopes of boosting that to \$10 billion a year. What does that mean to you and me? A lot more people out of work here in the states.

Have you ever read the book The Reckoning by David Halberstam, published in 1986? It is a frightening documentation on the history of how we gave the auto industry away to the Japanese. Perhaps The Reckoning II will be about how we gave away all of our manufacturing to the Chinese. We never seem to learn.

Going back to what was stated earlier, “China is still China.” The PRC is not on the way to capitalism and democracy. It is simply using capitalism and the lure of democracy for its own authoritarian purpose. China has its goals and has every intention of achieving them. The only thing that stands in their way is their own economy. And at the heart of that problem is:

The State Owned Enterprise

State Owned Enterprises (SOEs) were the brain-child of Stalin and designed by Mao Zedung. They were created to be the provider of goods to the state and be the primary deliverer of social services to the people. What they offered were low wages in return for lifetime employment and comprehensive social services (housing, medical care, schooling, the works). SOEs were like communities or company towns that in a completely self-contained society, could do well. However, in an interconnected world, they have become uncompetitive and have outlived their usefulness.

Fix it, Sell it, or Close it.

State Owned Enterprises are the greatest economic problem facing the People’s Republic. Today, at the beginning of the Tenth Five-Year Plan, China’s planners still do not know what to do to get out from under this albatross they have created. When Deng came to power, the state factories produced 75% of China’s industrial output. By 1995, seventeen years later, that figure was closer to 33% and it continues to decline. In the same period, the vast majority of these state factories lost increasing amounts of money. And today have become a tremendous drain on the Chinese economy. The PRC created a system in which these enterprises, especially the larger ones, cannot fail. As a result, these State Owned Enterprises have become China’s “critical factor.”

In the past, to ensure the SOEs continued existence, the central government directly subsidized them regardless of their P&L. These subsidies were basically grants that actually worked to de-incentivize the SOEs. With these grants, it did not matter how well or poorly they did, they would remain in business. But the rules have now changed. As part of today’s modern economy, SOEs are now supposed to be able to stand on their own two feet without government assistance.

Wash a dog, brush a dog, comb a dog it’s still a dog.

In an attempt to appear to have changed, the Peoples Republic has cleverly replaced direct subsidies with loans from state-owned commercial banks. Now SOEs account for about 70 percent of domestic lending. In theory, the SOEs are expected to pay those loans back. The PRC is hoping that by replacing subsidies with loans, it will instill a sense of financial responsibility in SOE managers. That the SOEs have a responsibility to repay the loan.

At least that is the concept. The reality of the situation is that loans from the state-owned banks to the state-owned enterprises have, in fact, been replaced by new ones when the old ones mature. Sometimes interest is paid to the banks and sometimes not, but for the bigger enterprises the loans are always rolled over. Thus they have begun to look to SOE managers like old grants. Most SOEs, if they repay at all, do so only when they are forced to and when there are no other options.

Although the banks are also state-owned, they do have depositors, who, unbeknownst to them, now share the risk for the failure of SOEs.

Which means it comes down to this. Should the state enterprises not pay back their loans, the state banks cannot pay back their depositors. Whether in China or the United States, banking is built on confidence, and these financial institutions, as a result of this manipulation, have been placed in harm’s way. The fear is that once ordinary depositors learn that the banks are insolvent, anything can happen.

Just to remind you again: China is ruled by an imperial-Leninist dictatorship.

But, unlike US Banks, Chinese banks get to play under different rules. Under Chinese law, creditors cannot put a SOE into bankruptcy without the consent of its government department-in-charge. What’s more, bankruptcy is not generally available when an enterprise is “public” or when it has “an important bearing on the national economy and the people’s livelihood.”

A good part of the reason for why the concept of bankruptcy does not sit right with the PRC is that it believes that its own cadres, and not the forces of the market or judges sitting in bankruptcy courts, should determine the fate of the state enterprises. Add to that the fact that Cadres refuse to admit defeat in all but the most hopeless cases and you draw to the conclusion that this is not a system that likes to confront its problems.

No matter how you look at it, state enterprises are effectively beyond the reach of creditors. Worse yet, creditors’ rights are often subject to outright government interference.

China’s Banks

Today, instead of one giant bank, there are four. The PBOC is no longer a commercial bank and the rural credit operatives still exists, but four commercial banks, entirely state-owned, dominate the landscape. At the end of 2000, the Big Four together held about 68.4 percent of the deposits and made some 71.0 percent of the loans in the banking system. Among them, they have a staggering 150,000 branches.

Churning as a way of life.

Today these Big Four depend on fresh deposits for liquidity. Without liquidity, their entire system collapses. Like musical chairs, when the music stops, the depositors will find that they are “chairless.” Fortunately for the Big Four, the Chinese are collectively among the world’s greatest savers, stuffing away about 40 percent of their gross domestic product year after year.

One other point you should be made aware of is that there is no deposit insurance system in China. No insurance means that the Chinese have only one option to protect their savings in time of uncertainty, and that is to make a run on the bank. Remember the scene from the movie *It’s a Wonderful Life?* Now imagine hundreds of millions of angry depositors. How do you think George Bailey (Jimmy Stewart) would deal with that mob?

Douglas Red, then head of ING Bank in Shanghai, about summed it up when he said: “The bad news is that the Big Four are insolvent; the good news is that they’re sovereign.”

Which brings us to Monday, September 17th when, according to an article in the Wall Street Journal, China is actually going to allow five small, one-branch Chinese-owned private banks in China to compete with the big four. This is China’s way of slowly preparing their \$2.4 trillion banking sector for the onslaught of competition coming to China in 2007. (Five years after China’s accession to the World Trade Organization, foreign banks can take deposits from local Chinese. The five year’s is up in 2007.)

"She swallowed the spider to catch the fly; perhaps she'll die."

In order to eliminate the state subsidies, China forced its state-owned banks to lend to the state-owned enterprises. A seemingly endless lifeline kept pumping money into these bottomless pits thus making the banks sick- very sick. No one knows the extent of the damage that the PRC has inflicted on its financial system. What is clear is that instead of one critical factor, China now has two.

One more thing to think about Chinese banks.

While China's banks act as guardians of its people's \$1.12 Trillion, China "reported" (they are a Communist, authoritarian government, you know) more than 8000 cases of financial fraud, totaling an estimated \$12 billion, in 2000 alone. Financial scandals have engulfed top bankers at Bank of China branches in Shanghai, Hong Kong and others. In the southern province of Guangdong, the Bank of China was taken for \$483 million. In June, dozens of bankers at the Construction Bank of Guangdong were charged with issuing \$120 million in fraudulent home-mortgage loans.

To give you an idea: China's banks lent 1.887 trillion yuan (\$228 billion) during the first seven months of this year. The 12-month figure for all of 2002 was 1.85 trillion yuan. The money is coming from US dollars. The flow of cash is being prompted by the speculation that the yuan will be revalued upward. In an attempt to curtail their loan growth, the Chinese banks have agreed to increase the percentage of deposits that commercial banks must hold on reserve to 7% up from 6%. The availability of money for housing loans for example has caused an out of control situation. There is little planning going into where and how they get built. Plus, steel and cement plants are springing up to feed the boom. As a result, they are removing about 150 million yuan from being available for loans.

The report of my demise was exaggerated.

You can read reports coming out of China on an almost daily basis. For example, official sources announce that SOEs on the whole turn profits for the state. That profit for 1998 was announced to be ¥49 billion (approximately US\$5.9 billion). In 1999, profits increased by about 77.7 percent, and in 2000 they grew by an eye-popping 140 percent.

Deception starts at the top.

The central government's own figures are crafted to be misleading. The 1998 profit figure of ¥49 billion, for example, does not take into account government subsidies of ¥150 billion (US\$18.1 billion). To those who know basic arithmetic (and this subject really should be taught at the Central Party School for cadres), these figures demonstrate that SOEs actually produced a loss of ¥101 billion (US\$12.2 billion). Profit figures for subsequent years are even less illuminating. When we look behind the figures for 2000 we see that half the profits were due solely to an increase in world oil prices, which permitted state companies to charge more for China's crude, and a quarter of the profits resulted from direct government subsidies, such as rebates of value added tax and the relief of the SOEs' debt to the tune of about ¥1.3 trillion (US\$157 billion). State officials deny that the SOEs heavily rely on state support to produce profits, but they're not fooling anybody.

Also excluded from the official statistics is a portion of the rapidly growing expenditures on the military, a closely guarded secret. Some think that about two thirds of the budget for the People's Liberation Army is not revealed; others say that 90 percent is hidden from view.

Just this past month, as released by the Dow Jones Newswire, the

National Bureau of Statistics reported "Profits at China's industrial companies rose a year-on-year 52.8% in the first eight months of 2003, to 501.5 billion yuan (\$60.6 billion)." They went on to say that "State-sector firms contributed to the rise: Their profits rose 66.6% to 253.8 billion yuan during the period. ... According to the figures, 38 out of 39 important industries recorded profit increases during the period. ... The statement said losses reported by unprofitable companies rose a year-on-year 5.3%, compared with the 6% growth in losses by unprofitable state companies." What can you and can you not believe?

We won't know the nation's true condition until Beijing produces reliable GDP statistics and reveals the true size of all the expenditures and other obligations that should be included as part of the central government's budget.

Welcome to the WTO

It seems that as long as the PRC can benefit from the WTO, it will participate. Adhering to WTO rules and regulations however, is another story. "By 2007," predicts economist Richard Cooper, "China will be in a massive non-compliance with WTO rules. ... Compliance with WTO rules would require the Chinese government to step back from control of the Chinese economy." And, that is not going to happen!

All the pain can be avoided if China just cheats and dishonors its WTO commitments.

"Let a hundred flowers bloom," said Mao, borrowing an ancient exhortation; "let a hundred schools of thought contend." And that's exactly what will happen as thousands of officials come up with their own interpretations of what WTO rules mean. Let a dozen ministries write new regulations, and we will have a hundred new ways to defeat the foreigner. And a thousand new disputes tomorrow. Chinese officials have a special genius for honoring obligations, but only as they interpret them. Each ministry in Beijing, each province and town, will act beyond the effective supervision of Beijing's senior leaders. It is happening today, and it will happen tomorrow. Trade promises mean nothing to local cadres seeking to protect the homeboys. One agreement to join the WTO is not going to change a history and culture that date back thousands of years.

Ask yourself, with whom, since 1949, when Mao took over, has China had an on-going friendship? Perhaps Korea, if you can consider that a relationship. Viet Nam, the Soviets and Albania all became bitter enemies of the Chinese. Why do we think it will be different with us?

But then again, perhaps it doesn't matter what they tell us.

Whether profitable or not; subsidized or loaned, what's going to be their downfall is the system they have put into place to keep their state enterprises afloat. The same system built to save them is the albatross around China's neck. Like a noose, it will only grow tighter as these state enterprises face more and tougher foreign competition fighting for a share of China's markets.

For the third time, let me remind you, China is ruled by an imperial-Leninist dictatorship.

Beijing has a wonderful industrial policy to make enterprises bigger by stifling competition. Which also means that only the central government can determine which enterprises will go out of existence. Closing state owned enterprises would mean tremendous unemployment. From 6.8 Million in 2001 to 20 million by 2005 according to the Chinese Ministry of Labor and Social Security. Figuring that it is a Communist run operation, you can bet that if they are willing to admit to 6.8 million, the actual number was closer to 100 million.

Unemployment Gone Wild

About a third of China's state-sector workforce is not productively employed now and will undoubtedly face redundancy as enterprises close down in the wake of entry to the WTO.

Yet as bad as conditions are in the cities, they are far worse in the countryside. The sector being hardest hit is agriculture. As much as 18 percent of China's land under cultivation will be taken out of production. Worse is the fact that rural poverty forces people off the land and into the cities, where they simply add to the throngs looking for livelihood.

Today, the number of surplus rural workers is somewhere between 150 to 200 million. Beijing estimates that another 9.7 million farmers will be forced to leave the land as a result of joining WTO. Still others think that the real number will be four times that. In Huangqia, a town in Jianli County of central Hubei Province, about 90 percent of the peasants have abandoned their homes and fields. Some have even abandoned their lives; suicides are on the rise.

It's not that there are too few crops—today there are simply too many. But what the peasants grow, often as dictated by the Party, a policy left over from Mao's "Great Leap Forward," is unprofitable. The source of the problem is that central planners don't care about efficiency; they just want to stockpile huge quantities. As a result, China is storing mountains of agricultural products, many of them unmarketable as the nation's tastes and needs change and as supply swamps demand. For example, some analysts estimate that the state and peasants are holding 500 million tons of low-grade grain, much of it unsaleable.

Analysts now say, for instance, that Chinese rice will not be able to compete with that grown in Australia—even in China's domestic markets. So no one thinks that primitive Chinese agriculture, as badly mismanaged by Beijing, has a chance.

It's a fact that the peasants of China will not be able to compete with the corporate farmers of, say, the American Midwest or California's San Joaquin Valley. When desperation arising from economic failure mixes with rage over corruption, rebellions will include provinces, not just townships, and hundreds of thousands of people instead of hundreds. The state will be armed and the peasants will not, but this will not necessarily be a contest where might will prevail. Who will want to stand against a genuinely popular movement in the countryside?

Mao Zedong used the term "prairie fire," and that's what will occur the next time, except that the countryside will ignite all at once. Nothing, he taught, can stand in the way of a people's movement.

Today the People's Liberation Army and the People's Armed Police are more than a match for any domestic enemy of the state. Yet in the future they could be overwhelmed by all of them at once. And that's exactly what will happen. As order dissolves across China, many groups will seize the moment. Workers will take over their factories, and towns will run themselves as little baronies.

A House of Cards.

Nothing frightens the PRC more than worker unrest. As a result they are terrified to allow their enterprises to fail. Therefore, China's only means for restructuring the SOEs is a strong economy. Only through growth can it absorb the millions who are being thrown into the streets. Then add to that the tens of millions of underemployed and those entering the workforce for the first time. The good news is that China has a boundless pool of workers. The bad news is that they

have to find jobs for them. China's number one priority: Find jobs for its people. At whose expense will they have to do this? Not just ours, but Mexico, Canada and the rest of the world, as well.

A Catch-22.

The key to China having a strong economy is privately owned enterprises, not the SOEs. However, privately owned enterprises need funds for expansion. The catch is that the state diverts capital to SOEs instead leaving the privates short funded.

Dealing with the problem.

Just fixing particular factories is not going to be the answer for the PRC. It is going to have to completely dismantle its entire state owned enterprise system. But, China is still China and they have a hard time of letting go of the past.

"You cannot just put a farmer in a factory and ask him to assemble computers."

Beijing is only beginning to understand that by the middle of this decade foreign enterprises may largely own China's economy.

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China goes out of its way to isolate its citizens from one another. Doing so only ensures that the people will hear its version of history first. "The only thing I can remember about June 4 is watching television and hearing that riot police had died," said Lu Jing, referring to the Tiananmen Square massacre of 1989. "I don't believe any students died," she volunteered. "China in this respect is democratic as China wouldn't hurt its own people."

The Tiananmen crackdown of June 4, 1989 was a calculated act of state terror to make the point that Communist rule was something that no one should question. Deng Xiaoping was not prepared to relent to the Tiananmen Square protesters, whatever their concept of democracy was. There would be no challenges to Party rule. The People's Liberation Army hunted the people in the streets of Beijing during the evening of June 3 and in the early hours of June 4 of that year. By dawn perhaps two thousand people were dead. The exact toll will never be known. It was state-sanctioned murder.

Enter the Internet and the end of blind ignorance, maybe.

As 2000 became 2001, there were about 22.5 million Internet users in China, more than double that of the year before. Multiple users per Internet account mean that many are uncounted. Internet usage in China is hobbled only by the prohibitive cost of PCs. The average person in a city has to work for more than two years before s/he can afford to buy a Chinese-made PC.

Mao Zedong sought absolute control over the Chinese population; his successors, living in a different age, are less ambitious and more realistic. China's new leader, Hu Jintao has already shown his colors on this topic. On September 9th, Beijing telecommunications regulators shut down four major Web sites for posting articles on political and constitutional reforms. The notice stated that the sites were not registered and did not have business licenses, in spite of the fact that many sites in China are not registered.

And finally, the Yuan

The new document, issued by the General Office under the Communist Party's powerful Central Committee, alleged that those promoting political reforms are actually attacking the Communist Party Leadership and the country's political system. It stated that external hostile forces have infiltrated China's domestic debate on political and constitutional reform and urged increased caution toward and vigilance against Chinese organizations use of foreign funding and China's cooperation with foreign experts and organizations.

Both Hu Jintao and his rival Jiang Zemin, who heads the powerful Central Military Commission know that they cannot stop the Net and still have economic progress. But, they will do their damndest to try and harness it and any other form of communications. For example, if you get the China Daily newspaper it is full of Party-line information. Should you subscribe to a foreign newspaper, it comes complete with its own wrapping paper, and is stapled or sewn shut. It is also missing pages or articles that have been removed by the censors. Even CNN will occasionally just go off the air. The official explanation is that they had a satellite malfunction.

It is far easier for censors to delete comments deemed offensive in the newspaper or on CNN than it is to control every Website.

In January 2000, the Party's Bureau for the Protection of State Secrets issued comprehensive Internet regulations that, among other things, require prior government approval before the disclosure of "information" and prevent the release of "state secrets."

Their rules are so strict, that on their face, they require any foreigner in China, other than diplomatic personnel, to register their cell phones and laptop computers with the State Encryption Management Commission and obtain approval for their use.

"In order to inspect the Internet, we must control it," says China's Public Security Bureau.

In addition to the Internet, there are also rules for all publications. As recently as August 8, 2001, China Central TV (CCTV), the party state television channel, announced its Seven NO's for news coverage. Any publication could be shut down if it published reports that: "negate the guiding role of Marxism, Mao Zedong Thought, or Deng Xiaoping Theory; oppose the guiding principles (The Four Absolutes- the socialist road, the proletarian dictatorship, the Communist Party's leadership, and Marxism-Leninism and Mao Zedong Thought.), official line or policies of the Communist Party; reveal state secrets, damage national security or harm national interests; oppose official policies on minority nationalities or religions, or harm national unity and affect social stability; advocate murder, violence, obscenity, superstition or pseudo-science; spread rumors or false news, or interfere in the work of the party and government; violate party propaganda discipline or national publishing and advertising regulations."

Enter a New Dragon.

Phoenix Satellite Television, a Hong Kong based network that is co-owned by Rupert Murdoch is the only foreign owned television channel with permission to broadcast news to the mainland in Mandarin, which is the dominant language there. "Phoenix is allowed to exist because it never infringes on the ideological principles of the Chinese Communist Party," said Chip Tsao, a freelance editorial writer in Hong Kong. There is good news and some bad news. The good news is that by all accounts, it is a very big hit with its viewers. (I wonder how the Chinese will like Joe Millionaire?) The bad news is that satellite dishes are illegal in most of China so getting the channel is a challenge in itself. You either need a contraband satellite dish, have illegal access to cable, or live in an authorized area. To learn more on this, see the Los Angeles Times article in Monday, September 1, 2003 edition, page one, column one, Changing Channels in China.

Regarding the yuan, one must understand that under Mao, the realm of the market, in which money ruled, was trivial compared with political hierarchy, from which decisions or economic life cascaded. The Chinese yuan was not convertible with other currencies. This way, production, housing, prices, wages and construction were all "planned" by the party-state. It was all part of Mao's Great Leap Forward which proved a complete and utter disaster. However, rather than renounce the centrally planned economy, Mao simply sought scapegoats for its failure.

More on the Yuan.

It is also known as the renminbi. It's been pegged at 8.28 to the dollar since mid-1997. By keeping the rate low, China makes its manufacturing goods cheaper in overseas markets. It also explains the \$100 billion trade deficit we have with them.

How It's Done:

There is magic in Shanghai. Investors pour in money, like dollars, and would normally have to sell their dollars in exchange for a yuan. This in turn, would cause the yuan to increase in value. But, the central bank, through tightly controlled Shanghai foreign-exchange market, sells yuan to put enough downward pressure on the Chinese currency to keep it stable against the dollar. Not only does the yuan remain stable, but China has accumulated an enormous pool of foreign-exchange reserves. Much of which it invests in US Treasury Securities. For example, China invested more than \$96 billion in US government securities in the last 12 months. In simple terms, what that means is, they are helping to keep our interest rates low. By raising the value of the yuan, our own interest rates could go up.

By keeping the yuan down, China can stimulate their own employment and keep their deflation in check. A lower currency tends to help exports and raise prices domestically.

One must also keep in mind that until 2007, the Chinese people can only put their money in Chinese banks. Should the money flow away from the Chinese banks, the yuan can actually go down on its own.

Two years ago, China agreed to float the yuan by 2008 as part of its WTO agreement. According to an article by Jeff D. Opdyke and Jane J. Kim in the LA Times on Wednesday, September 10th, if the Yuan climbs to five to the dollar, representing a roughly 40% gain, which many pros see as likely if the currency is set free. The result: A dollar invested today would be worth \$1.66. Even if it takes China until 2008 to fully float the yuan, that represents a roughly 14% average annual return.

On the other hand, companies like Wal Mart and New Balance Athletic Shoe Co. do not want to see the yuan go up. For Wal Mart, Chinese products account for some 70% of what they sell. Re-evaluating the yuan would mean higher prices at Wal Mart. For New Balance, about 60% of the 40 million shoes they sell comes from China. Quoted from a WSJ September 4th article, "Revaluation would mean increased prices for our products around the world," says Darren Tucker, its regional manager, Pacific Asia. **HOLD IT AND STOP RIGHT THERE!!** Here in the US, we are looking to be more productive. We seek continuous improvement, higher efficiencies, more effectiveness, doing more with less and becoming lean, mean fighting machines. Can they say that in China? I sincerely doubt it. So, while we have to look at everything imaginable and even things unimaginable to stay competitive, they just look at the yuan and say if you revalue it, our prices go up. **NO!** Revalue it and then get to work becoming more productive just like we have to do!! Give me a break!!

Who else would like to see the yuan stay where it is?

The Chinese people! If it appreciates it erodes the buying power of their dollars. Exchanging yuans for US currency in China used to be something done on China's Black Market. Today, however, with our interest rate cuts, the dollar is not in great demand in China. Interest rates on dollar deposits have gone from 1.98% to 0.5625%. If the Chinese ever lose confidence in the yuan once they are able to choose between the yuan, the dollar or any other currency, China could be hit with a financial crisis.

What Will Cause China's Eventual Downfall

One of the same things that is affecting us -- an aging population. In 2001, some 10% of its population was over 65. By 2030, it will be 25%.

Another is widespread healthcare problems. Between AIDS and SARS, China is hard pressed to deal with its healthcare problems. According to the World Healthcare Organization, China is 144, one of the worst in the world.

A third is their banking system. Banks making bad loans to state owned enterprises that will never be repaid using the savings of the Chinese people. (I think we call that "kiting" here.)

Fourth is what they are doing to their own environment. They have nine of the world's worst polluted cities. More than half of their rivers are putrid. China's mines have the world's worst safety records. And there seems no end in sight for how much worse it is all going to get. China's impressive economic development, for instance, has been purchased at the cost of severe environmental degradation. China boasts, if that is the right word for it, nine of the world's ten most polluted cities, including the one that may just be the worst, Lanzhou, the capital of central Gansu Province.

Somewhere between 4 to 8 percent of GDP is lost through destruction of the environment. About 350 million of China's citizens, more than a quarter to the total, remain desperately poor with little relief in sight. It will be difficult for the nation to progress economically without alleviating their poverty. The state does not provide education or health care for hundreds of millions in rural and urban areas.

Fifth, is what was mentioned before -- a government collapse resulting from an uprising from within. Tibet, Xianjiang, Taiwan, the unemployed, and the Chinese people (especially when they find out that the savings they thought they had secured away in China's banks aren't there and when they have had enough of the political corruption and the pocketing of money going on right before their eyes), all rebelling.

Sixth is a combination of one through five.

For some of us, it might be hard to believe that the People's Republic could ever fall. But, perhaps we need to defer to Leon Trotsky who said, "Revolution is impossible until it is inevitable." There is also a Chinese saying that goes, "There are many things which cannot be imagined but there is nothing which may not happen."

Just remember this, however. No regime in Chinese history ever went down without bloodshed. When it goes, it is going to be ugly. And when it goes, what happens to all of those businesses there? What happens to the world's economy then? I don't know about you, but in spite of being more expensive in terms of manufacturing here in the states, at least I know we are not expecting it to collapse any time in the near future. To ensure that that does not happen, we have a Constitution that allows us to elect our government officials. What a concept!

"Society moved on, and the Party stayed where it was," Alexander

Rutskoi, deputy of the Russian Parliament, said, referring to the Soviet Communist Party. And when that happened, the end was inevitable. Is that what is happening to China? Stay tuned.

Whether a country or a business, there is a lot in common.

John Stuart Mill summed it all up in 1859 when he wrote, "The worth of a State, in the long run is the worth of the individuals composing it... A State which dwarfs its men, in order that they may be more docile instruments in its hands even for beneficial purposes -- will find that with small men no great thing can really be accomplished."

Obviously, the PRC is not a top down bottom up organization. It is strictly top down. The Great Wall of China was not built to keep people out, it was to keep people in! Its vision and its destiny is to control the Chinese people for all time.

The vision to see. The capacity to lead. The faith to believe. The courage to change. The confidence to serve. The commitment to accomplish. These are the things that make for great nations and great companies.

What Can We Do?

First and foremost the biggest difference between the United States and China is that we get to elect our officials. As good or bad as they are, we at least have the constitutional right to go to the polls and decide who represents us. Where in which the solution lies.

When the Irish were the downtrodden of the immigrants, they took to the polls and elected mayors, police chiefs, ward aldermen, council members, congressman, senators and eventually the president of the United States. When the unions couldn't get anyone to listen to them they too took to the polls. Now it's our turn. We need to elect officials who understand manufacturing. We need to elect officials who understand a level playing field when they see one. Not those whose pockets are lined with multi-national corporation money.

What we have in common with the Chinese is graft, corruption, greed and avarice. Like them, we have people representing us (in their case it is cadres, in our case it is congressmen and senators), who would rather take personal gain over seeing to it that there is a United States tomorrow. We are going to have to weed those people out. We are going to have to test their mettle and hold their feet to the fire. And some of you out there are going to have to run for office.

What in the hell can we do that is going to make a difference?

First off, we have to educate the American people. They go to Wal-Mart because the things sold there are inexpensive. Do they care that it says, "Made in China." Probably not. Should they? Yes. If they knew that with every purchase they make they take one step closer toward the unemployment line, they may reconsider.

The next thing we have to do is get the environmentalists involved. Why is it that every product made in America has to be produced in an environmentally friendly manner. Yet, it is all right to purchase environmentally unfriendly Chinese products. They are destroying their environment and there isn't a peep out of the "Greenies" as to why we should not buy Chinese products.

Third is to get the Unions to better understand what they are up against. If they continue to ignore this problem they can bet it will go away. The unions, not the problem. The time has come for the unions to work hand in hand with manufacturing to keep manufacturing here, not send it off shore. You are either part of the solution or part of the problem.

Fourth is to get an even playing field. We need to quit working under fear. We need elected officials with the chutzpah to tell the UN, the WTO and China that we all either play under the same rules or we walk. If you want our military protection, if you want our foreign aid, if you want our people to continue buying your foreign goods, then “listen up!” If we have to have OSHA, the EPA, workers’ comp insurance, insurance on our buildings and equipment, product liability insurance in case some idiot misuses one of our products, place warning labels on step ladders, pay taxes, provide health care, pay into social security and even have the first \$100,000.00 on deposit in our banks federally insured, then so should everyone else. If the “One Worlder’s” really want One World, then it damn well be universal, equal and fair. The WTO is a joke, as is Gatt and NAFTA.

Fifth, we need elected officials with the chutzpah to tell our own multi-national companies that “yes, you have a right to take your manufacturing overseas, but it’s going to cost you.” You want to open factories in China to sell to the Chinese and other Asian nations, have at it. But none of those products can be sold here. Whatever you sell here has to be made here. In the case of an automobile, at least 60% of what goes into that car has to be made right here in the USA. And whatever you sell here has to be sold at a comparable price for whatever you are selling it for in Asia.

Sixth, any corporation that decides to leave the United States and take up residency in another country will no longer be recognized by the United States and can no longer sell its products in the United States. Should the product(s) they offer be proprietary the federal government will “quickly and easily” loan money, at substantially low, long term interest rates to any US company who can prove they can duplicate or improve upon those proprietary product(s).

Seventh, we need people who are willing to re-engineer the Department of Commerce and the SBA. We need a user-friendly system that is uniform and fair. We need an SBA that could care less about your race, creed or color or collateral. We need an SBA that has the true wisdom, experience and expertise to look at a business plan and know whether it has a snowball’s chance in hell of succeeding or not. As a matter of fact, we need two SBA’s. One for the little guy who wants to open a restaurant or beauty salon. Another strictly for manufacturing.

Eighth, we need to hold the rest of the world accountable. As of September 11th, 2001, the world is a different place. America, thanks to George W. Bush, didn’t wait around to see what was going to happen next. We proactively went after the bad guys (see our 9/11 tribute at: www.altfeldinc.com/library.html). Only this isn’t like the old days where the bad guys lived somewhere. They don’t reside in a country as did the Axis Countries of WWII. These bad guys are all over like dirty water. My point being, that you are either with us and will support us monetarily and with troops, or your products are no longer welcome in the United States. We need to give those countries that want our money but will not provide us with the support we need, three distinct and clear orders: “Get Out. Stay Out. And, Don’t Come Back!” I am not in favor of *laissez faire*, nor am I promoting the concept. I am merely promoting the fact that we are either America from the Jimmy Carter era who went around apologizing for everything, or we are America from the Reagan era who demanded, “Mr. Gorbachev, tear down this wall!” Personally, I am a protégé of Jack Welch, a product of the sixties and a dyed in the wool Reagan-ite so you know where I stand.

Ninth, we need to get the Banks to understand their role in keeping manufacturing here. Sit down with your bankers and get them to get back involved in the community. Pick their brains on what they can do to help the manufacturers on a local level. Get them involved, informed and inspired to want to take it up to the next level within their bank.

Tenth, we need the president to assemble a team of visionaries to create an inspiring shared picture of the future America that can motivate and rally the people. I feel as though we are being far too influenced by a bunch of congressman attorneys telling us only what we can’t do and who are never brave enough to stick their necks out to tell us what we can do. Whether you liked Reagan or not, he fulfilled his vision. He reduced taxes, got the Government out of our lives, was directly responsible for the tearing down of the Berlin Wall, and dismantled the “Evil Empire” known as the Soviet Union. (Or perhaps you prefer the Carter era of boycotting the Olympics because the Russians invaded Afghanistan; asking the Israeli’s to get our people out of Entebbe because our own helicopters were falling apart; giving away the Panama Canal; and not only allowing our people to be held hostage in Iran long enough to let Ted Koppel make a name for himself, but truly doing nothing about it.) We need to know where this great nation is going, how we are to get there and what we can do to ensure that it does.

Eleventh, we need to get rid of our “Let George Do It” attitude and get involved. Each and everyone of us needs to designate ourselves plus at least one other person in the company to become active on a local, state and national level. First off, join NAM, NFIB, or any other manufacturing association with local, state and/or national clout. Next, go after your assemblyman, your state representatives, and your national congressmen and senators. Start demanding information. Start forcing them to collect data that will in turn make them aware of what is going on. How many jobs have left the city in which you work? What effect has that had on your city, the state and the nation? Propose things that your city can do on a local level to encourage manufacturing. Propose things the state can do? Propose ways that manufacturing can get favored industry status.

Twelfth, form town hall sessions on a local level with other manufacturers, bankers, your local congressman, etc. and discuss the issues. Put an agenda together and with but a few key topics you can thoroughly address in a limited time frame.

The time has come for all brave manufacturers to come to the aid of their country. Or, as Winston Churchill stated in the shortest commencement speech ever given, “Do it!” **A**

Registration Form – Coalition for the Future of Manufacturing Statement of Mission, Principles and Activities

Mission Statement. The coalition is dedicated to raising awareness, particularly among elected officials, of the critical importance of a strong manufacturing base to American prosperity and the challenges facing U.S. manufacturers today, and to seeking pro-growth public policy changes that will ensure a vibrant U.S. manufacturing base in the future.

<http://www.nam.org/secondary.asp?TrackID=&CategoryID=1119>

Who’d a Thunk it?!

The independent state auditor produced a 153 page document that basically blames state officials for our worker’s comp crisis here in California. Duh! Wouldn’t you think that if something goes from \$9 billion in 1995 to \$29 billion in 2003, someone would yell “FIRE!” According to State Auditor, Elaine M. Howle, she blames state officials for failing to set applications on what insurers pay for medical services or the number of visits injured workers can make to doctors, physical therapists chiropractors and others. To give you an idea of how goofy it is, Costco Wholesale Corp. operates in 36 states. Yet, 70% of their worker’s compensation costs come from California, even though only one third of its employees work in California. By the way, in case you missed it, Levi Strauss, an American Original, just closed its last manufacturing plant in North America and headed East for the new gold rush of the 21st Century.

Thought for the Day

You may consider hiring or appointing a Safety Officer if you don’t already have one. Believe it or not, according to the Labor Dept., smaller companies tend to do more poorly on workplace safety and actually account for a disproportionate amount number of worker deaths. You may want to ask your insurer how much you would save on premiums with an improved safety record. You may also want to check out www.osha.gov for resources.

ON THE HOME FRONT

Paxton Sells to ITW as a Direct Result of Altfeld's Efforts

September, Camarillo, Ca. - - In a whirlwind sale, Paxton Products was purchased from the Granatelli Brothers by Illinois Tool Works Vortec out of Cincinnati, Ohio. According to Vince Granatelli, "ITW Vortec was interested in purchasing Paxton from my brother and I close to three years ago. Upon doing their due diligence however, they decided to pass on making us an offer." Granatelli added, "We'd heard about Altfeld and retained him for his strategic planning, marketing and sales consulting to re-engineer the company. And it paid off. ITW directly attributed their wanting to purchase Paxton, this time, to his efforts and results. They saw a significant difference between then and now. And so did we."

According to Altfeld, "I spent two to three days a week at Paxton, as well as working trade shows, meeting with key accounts and establishing a North American rep organization for them. In addition to doing the strategic planning, I was their outsourced Marketing Manager. By the end of the second year, Paxton was a strategically aligned, horizontally integrated, customer focused business with everyone pulling on the same rope in the same direction. We successfully shifted their marketing and sales strategy and for the first time in 45 years they had a solid rep organization in place. The best part was that they were actually realizing strong sales in a down economy."

Paxton Products, an ITW Company, designs and manufactures compact, energy-efficient, blowers, air-knives, and drying systems for industries around the world. It is a recognized leader in energy-saving, application-specific air systems.

For more information on how Altfeld Inc. can help your business visit our web site at www.altfeldinc.com. Or, call Jim Altfeld at 1-800-397-0010 to schedule an appointment.

The 2003 Tax Relief Act: What Does It Mean for You?

You've heard a lot of talk about the \$350 billion tax relief package -- experts discussing raised expensing limits, accelerated tax-rate reductions, and so on -- but what does all of that mean for your bottom line?

Well, it's mostly good news. The only bad news is that you have a limited amount of time to take advantage of the tax savings. Here's a closer look at how to get the most bang out of the bill. Three provisions of the 2003 Tax Relief Act are particularly beneficial for small businesses:

*Increase in expensing

What it means: You can immediately quadruple your deductions, from the current \$25,000 up to \$100,000 now, and receive a 50 percent bonus write-off for new equipment, up from 30 percent. This gives small business owners substantial cost-savings when buying new equipment, software, vehicles and supplies. BUT: The expensing limits return to previous levels in 2006, and the bonus depreciation expires in 2004.

*Accelerated reduction in income-tax rates

What it means: A reduction in income taxes previously set to take effect in 2004 and 2006 takes place immediately. At least 85 percent of small business owners file tax returns as individuals, so any tax refunds and increased earnings will go back into their businesses. The Department of Treasury finds that 23 million small business owners will receive tax cuts averaging \$2,209. BUT: Tax rates return to their previous levels in 2011.

*Accelerating the reduction in the top marginal rate

What it means: Those in the top bracket, two-thirds of whom are entrepreneurs, will receive an immediate tax reduction to 35 percent, rather than waiting until 2006. That gives small business owners 79 percent of the \$12.4 billion granted in this relief. BUT: Tax rates return to their previous levels in 2011.

In Case You Missed It

US employer's health insurance premiums went up an average of 13.9% this year. According to a survey conducted by Kaiser Family Foundation and the Health Research and Educational Trust Fund, this is the most it has risen since 1990 and is the third straight year of double-digit percentage increases. In spite of increase, fewer companies shifted the cost over to the employees than occurred in 2002.

The average worker contributions for health coverage rose about 8% for single coverage to \$42.00 per month, and 13% for family coverage, or \$201 per month.

TELL US WHAT YOU THINK. Give us your input on what we've covered as well as any other topics you would like to see addressed. Or, if you are just peeved about something that pertains to business, feel free to speak your mind. Contact us by email: jaltfeld@altfeldinc.com

Roncelli Plastics is Awarded Preferred Supplier Certification from Boeing Thanks in Part to Altfeld, Inc.

October 2003, Monrovia, Ca. - - Roncelli Plastics, a machining and fabrication center for plastic components and parts has been awarded the Bronze level of Boeings prestigious Preferred Supplier Certification. Representatives from Boeing presented the award on October 13th to Gino Roncelli, CEO and President and Riley Cole, Roncelli Plastics' vice president and general manager, during a ceremony in Monrovia, California.

Supplier certification includes an on-site evaluation of suppliers in three areas. Advanced quality system, business processes and demonstrated performance. Suppliers are assessed and evaluated on leadership, quality, product delivery, cost, technology and support. It identifies suppliers who are committed to continuous improvement in both processes and products.

"This is a major recognition of our ability to meet the demanding manufacturing requirements of the aerospace industry and we are certainly proud of this achievement." said Riley Cole, Vice President and GM of Roncelli Plastics. "We could have never achieved this without the efforts of Jim Altfeld and Altfeld, Inc. Without his having worked with us over the past two years, we would not have had the leadership, focus, direction and continuous improvement programs in place that we have now."

Roncelli Plastics manufactures plastic components for most major aerospace companies including Boeing, Northrop Grumman, Honeywell, Lockheed Martin, and Raytheon. The company will celebrate its 35th anniversary in January of 2004.

The Boeing Company is the world's largest manufacturer of satellites, commercial jetliners and military aircraft. In terms of sales, Boeing is the largest exporter in the United States. Total company revenues for 2001 were \$58 billion.

At Your Service

Many companies are not strategically aligned, horizontally integrated and customer focused. Many don't have a marketing plan and simply allow the "sales gods" to determine how they're going to do each year. Many companies rely far too much on the owner or president for direction, guidance and decisions. And many more companies lack good communication, cooperation and collaboration. If any of these symptoms describe your company, call us to speak with Jim Altfeld for a free consultation. Jim is available for strategic planning, marketing and or sales consulting and can help your company become less dependent upon you for its survival.

For more information on how Altfeld Inc. can help your business visit our web site at www.altfeldinc.com. Or, call Jim Altfeld at 1-800-397-0010 to schedule an appointment.

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